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MONTHLY TAX FEATURES

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U.S. Debt Ceiling Hits $1.3 Trillion in Wake of High Spending, Deficits

Once again, on the eve of the 1983 fiscal year, Congress approved an increase in the Federal debt ceiling to enable the government to continue its operations. The latest action raised the ceiling to $1.290 trillion, almost 13 percent above the existing $1.143 trillion level, effective October 1, 1982, the start of the fiscal year.

The increase was necessary in view of substantive legislation previously approved by Congress leading to higher levels of spending and debt, and in the light of expectations concerning revenues. The new limit, approved by the House earlier in the year, had been delayed in the Senate from August 15 to September 23 by debates on unrelated social issues. The action will enable the Treasury to continue borrowing to finance deficits now estimated at about $109 billion in fiscal 1982 and between $140 and $160 billion in fiscal 1983.

Although the Federal fiscal year 1982 ended on September 30, the final Treasury figures on outlays, receipts, and the exact size of the deficit will not become known for several weeks after that. The latest budget revisions of the Office of Management and Budget place the estimated deficit for 1982 at $108.9 billion.

Even in the unlikely event that the final number is somewhat less, the 1982 deficit will be the largest in history, exceeding the previous record

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House Budget Chairman James R. Jones Named For 1982 Distinguished Public Service Award

Congressman James R. Jones, Representative of the 1st District of Oklahoma and Chairman of the House Budget Committee, will deliver a major address at the Tax Foundation's 45th Annual Dinner on Wednesday, December 1, when he receives the Foundation's Distinguished Public Service Award for 1982. The dinner will be held at the Plaza Hotel in New York City, and will be preceded by a formal reception at 6:00 p.m.

Jones is now in his fifth term in the House of Representatives. In addition to heading the Budget Committee, he is a ranking member of the House Ways and Means Committee, Chairman of the House Democratic Research Organization, and a member of the House Democratic Steering and Policy Committee.

The dinner in honor of Chairman Jones follows the Foundation's day-long 34th National Conference on "The Federal Fiscal Dilemma—Is There a Solution?" at which economists and public finance experts will explore the major tax and fiscal issues confronting the nation. The conference will also be held at The Plaza. Keynote speaker at the luncheon will be The Honorable Wilbur D. Mills, former Chairman of the House Ways and Means Committee and twice recipient of the Tax Foundation's Distinguished Public Service Award.

For further information about the 34th National Conference and 45th Annual Dinner, or to obtain a reservation form, contact the Tax Foundation, 1875 Connecticut Avenue, N.W., Washington, D.C. 20009, or telephone 202/328-4500.

Federal Budget Deficits, Debt Outstanding, and Related Measures
Selected Fiscal Years 1975-1982
(Billions)

Year	Receipts	Outlays	Surplus/ deficit (–)	Interest on debt	Debt outstanding[a]
1975	$279.1	$324.2	$ –45.2	$ 32.7	$ 544.1
1976	298.1	364.5	–66.4	37.1	631.9
T.Q.[b]	81.2	94.2	–13.0	8.1	646.4
1977	355.6	400.5	–44.9	41.9	709.1
1978	400.0	448.4	–48.8	48.7	780.4
1979	463.3	491.0	–27.7	59.8	833.8
1980	517.1	576.7	–59.6	74.9	914.3
1981	599.3	657.2	–57.9	95.6	1,003.9
1982[c]	622.1	731.0	–108.9	118.2	1,137.1

[a]End of fiscal year.
[b]Transition quarter.
[c]Estimates from Mid-Session Review of the 1983 Budget.
Source: Treasury Department; Office of Management and Budget.

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The Front Burner

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"Do not let your left hand know what your right hand is doing."

At the risk of becoming excessively biblical, the text cited above came to mind as soon as we began to take a hard look at the way tax and fiscal policy have been conducted for the last two years.

The Economic Recovery Tax Act of 1981 (ERTA) was a strong start down the right road—accelerated cost recovery, reduction of the corporate tax rate, revised leasing provisions to help unprofitable companies, lowering of the tax on capital gains, incentives for research and development, and the three-year personal tax cut.

Then came TEFRA—the Tax Equity and Fiscal Responsibility Act of 1982. It might better have been called the Tax Exacerbation and Fiscal Revocation Act. Recent memory fails to uncover a major piece of legislation so inaccurately named. There is little equity and less fiscal responsibility in TEFRA or in the way the bill was written.

TEFRA is pure election-year politics. It takes a little bit from many groups to forestall concerted opposition. Its origins in the Senate Finance Committee—of at least dubious constitutionality—gave House members the chance to keep their fingerprints off an election-year tax hike. It also gave those up for election a way to argue that they were not trying to balance the budget on the backs of the poor and working man.

TEFRA repealed nearly half of the business relief included in the 1981 tax bill, leaving a number of companies worse off than they would have been had there been no tax bills in 1981 and 1982.

But as bad as TEFRA is, the big hypocrisy lies in the gap between Congress's promise and performance with regard to spending cuts.

The House and Senate promised in the First Concurrent Budget Resolution to enact tax increases of $20.9 billion in fiscal '83, $36.0 billion in fiscal '84, and $41.4 billion in fiscal '85. TEFRA did that.

The resolution promised spending cuts of at least $200 billion over the next three years. Congress delivered $7.0 billion in fiscal '83, $10.6 billion in fiscal '84, and $13.1 billion in fiscal '85—a grand total of $30.7 billion in real cuts. That's a shortfall of about $170 billion. Even for the U.S. Congress, that's a huge gap between promise and performance.

That shortfall sends a clear message: When it comes to the presumed link between taxing and spending, in the U.S. government, the left hand obviously does not know what the right hand is doing.

State and Local Work Rolls Show 1.6% Decline; First Decrease in Such Employment in 35 Years

After 35 years of continuous growth, state and local government employment may be entering a declining phase, according to Tax Foundation economists. Data for the month of October, compiled annually by the Census Bureau, revealed that in 1981, latest year reported, the number of workers on state and local payrolls dropped by 212 thousand, or 1.6 percent, from the previous year.

In October 1981 there were 13.1 million full and part-time employees on state-local government payrolls, as compared to the all-time high level of 13.3 million in October 1980. On a full-time equivalent basis, the number of employees fell from 11 million in 1980 to 10.9 million in 1981, or 1.2 percent.

Although the rate of growth in state-local employment has been easing downward for several years, the 1980-1981 decline is largely attributable to Congressional action last year in ending the public service employment portions of the Comprehensive Employment and Training Act on October 1, 1981. Other factors tending to restrain employment growth are declining enrollments in public schools, and recession-induced budgetary pressures requiring some cutbacks in the workforce of many states and localities.

Local governments employ more than twice as many persons as state governments. In 1981 there were 7.8 million employees on local government payrolls and 3.1 million on state payrolls. Almost one-half of all state and local employment is in the field of education.

For the decade 1971-1981, the number of full-time equivalent employees on state and local government payrolls jumped by more than 2.1 million—from 8.8 million in 1971 to 10.9 million in 1981 (24 percent for the period, and about 2.2 percent per year). During the 1950s and 1960s, however, as the rate of growth exceeded 4 percent per year, state-local employment grew much faster than population in general. For the 26-year span from 1951 to 1977, full-time equivalent employment increased about twice as rapidly as total population.

Full-time equivalent employees per 10,000 population rose from 248 in October 1951 to 495 in October 1977. For the past two years, however, the ratio of state-local employees to the public they serve declined from a peak of 497 employees per 10,000 population in 1979, to 488 and 476 in 1980 and 1981, respectively.

Despite the reduction in employment from 1980 to 1981, payrolls rose by 8.3 percent—from $14.7 billion to nearly $16 billion. (Thirty years ago, the October payrolls of state and local governments were only slightly more than $1 billion.) Last October, two states had payrolls topping $1 billion: California with $2.1 billion and New York with $1.6 billion. Following them were: Texas, Illinois, Michigan, Pennsylvania, and Ohio, with October 1981 payrolls of $938 mil-

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To Our Readers

Tax Review will not be published in October 1982. Publication will resume with the November/December issue.

Special Purpose Units Multiply as Local Jurisdictions Splinter

General-purpose local jurisdictions in the United States may be yielding to more splintered forms of government, as units designed to provide a single service or a limited range of services proliferate, say Tax Foundation researchers.

A new survey by the Bureau of the Census counts a total of 82,637 such units in operation at the beginning of 1982. That represents an average of one local government unit for every 2,788 persons in the country—or 1,654 local units per state.

Included in the total count are 38,872 general-purpose jurisdictions (counties, municipalities, and towns and townships), 28,733 special districts, and 15,032 school districts.

Over the last 20 years, the number of general-purpose local governments has remained fairly stable. (There are 687 more such units today than in 1962.) However, special districts have increased dramatically during this period, reversing a long-term decline in the number of local government units.

Over 90 percent of these special districts exist to perform single functions or to oversee specific areas of responsibility. They include various commissions, authorities, boards, and other entities with sufficient autonomy to merit distinction from the administrative structure of any other government units.

Since 1972, the total number of local government units in the United States has risen by 5.6 percent, and general-purpose governments have increased by only .8 percent. At the same time, school districts have decreased in number by 4.7 percent. Special districts have risen, in contrast, by 20.3 percent.

The finances of special districts, not surprisingly, have also grown more rapidly than those of other local units. In 1980 (latest year reported) expenditures for special districts totaled $24.9 billion, an increase of 192 percent since 1972, as compared to a rise of 114 percent in spending for all other

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Number of Governmental Units in the United States
Total by Level of Government by State, 1982
Selected Years 1942-1982[a]

Year and state	All government units[b]	Counties[c]	Municipalities	Townships and towns	School districts[d]	Special districts
A. Total units						
1942	155,116	3,050	16,220	18,919	108,579	8,299
1952	116,807	3,052	16,807	17,202	67,355	12,340
1957	102,392	3,050	17,215	17,198	50,454	14,424
1962	91,237	3,043	18,000	17,142	34,678	18,323[e]
1967	81,299	3,049	18,048	17,105	21,782	21,264
1972	78,269	3,044	18,517	16,991	15,781	23,885
1977	79,913	3,042	18,862	16,822	15,174	25,962
1982	82,688	3,041	19,083	16,748	15,032	28,733
B. Detail by state						
TOTAL	82,688	3,041	19,083	16,748	15,032	28,733
Alabama	1,019	67	434	—	127	390
Alaska	157	8	142	—	—	6
Arizona	459	14	76	—	231	137
Arkansas	1,430	75	472	—	376	506
California	4,112	57	428	—	1,115	2,511
Colorado	1,568	62	267	—	207	1,031
Connecticut	481	—	33	149	16	282
Delaware	219	3	56	—	19	140
District of Columbia	2	—	1	—	—	1
Florida	972	66	391	—	95	419
Georgia	1,271	158	534	—	188	390
Hawaii	19	3	1	—	—	14
Idaho	1,018	44	198	—	117	658
Illinois	6,464	102	1,280	1,434	1,050	2,597
Indiana	2,873	91	565	1,008	306	902
Iowa	1,874	99	955	—	457	362
Kansas	3,819	105	627	1,380	326	1,380
Kentucky	1,253	119	426	—	180	527
Louisiana	469	62	301	—	66	39
Maine	808	16	22	475	98	196
Maryland	443	23	152	—	—	267
Massachusetts	799	12	39	312	81	354
Michigan	2,646	83	532	1,245	601	184
Minnesota	3,530	87	855	1,795	436	356
Mississippi	860	82	292	—	169	316
Missouri	3,128	114	929	324	559	1,201
Montana	1,045	54	126	—	412	452
Nebraska	3,336	93	535	469	1,080	1,158
Nevada	186	16	17	—	17	135
New Hampshire	507	10	13	221	149	113
New Jersey	1,597	21	323	244	553	455
New Mexico	320	33	96	—	89	101
New York	3,301	57	615	932	773	923
North Carolina	910	100	484	—	—	325
North Dakota	2,798	53	365	1,360	325	694
Ohio	3,353	88	941	1,318	627	378
Oklahoma	2,262	77	582	—	653	949
Oregon	1,460	36	241	—	354	828
Pennsylvania	5,317	66	1,019	1,549	618	2,064
Rhode Island	125	—	8	31	3	82
South Carolina	652	46	265	—	92	248
South Dakota	1,768	64	312	996	195	200
Tennessee	914	94	335	—	13	471
Texas	4,192	254	1,121	—	1,125	1,691
Utah	506	29	224	—	40	212
Vermont	668	14	57	237	274	85
Virginia	408	95	229	—	—	83
Washington	1,735	39	265	—	300	1,130
West Virginia	637	55	231	—	55	295
Wisconsin	2,596	72	580	1,269	409	265
Wyoming	401	23	91	—	56	230

[a]Data for 1982 are preliminary.
[b]Includes the Federal government, the District of Columbia, and the state governments. Alaska and Hawaii are included beginning 1952. Among the local units, 67,780 had property-taxing power in 1977.
[c]Includes areas corresponding to counties but having no organized county government.
[d]Includes local school systems operated as part of state, county, municipal, or township governments.
[e]Beginning 1962, data are not strictly comparable to prior years because of a change in classification.
Source: Department of Commerce, Bureau of the Census.

U.S. Debt

(Continued from page 1)

of $66 billion experienced in fiscal year 1976. In both years much of the deficit could be attributed partly to severe contractions in economic activity—the deepest in the post-World War II period. In addition, the latest deficit also reflects Congressional action in 1981 in approving significant tax reductions.

Examining budget trends since the mid-seventies, TF researchers note that, from 1975 to 1982, budget outlays and receipts both have grown by amounts averaging 12 percent each year. Outstanding debt has increased at the slightly slower rate of 11 percent annually.

Annual interest payments on the debt, however, have risen at annual rates of close to 20 percent, in response to larger and larger Treasury borrowings at high rates of interest. Interest on the public debt in fiscal 1982 is estimated at $118.2 billion, an increase of 24 percent over fiscal year 1981.

Even on a net basis, budget outlays for interest in 1982 totaled about $83 billion (after deducting interest paid to agencies by the Treasury on some trust fund assets). At this level, interest is the third largest category of Federal spending. Income security (social security and related programs) claims 35 percent of the Federal budget dollar; national defense, 30 percent; and interest, 11 percent.

The table on page 1 gives details.

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State-Local Jobs

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lion, $800 million, $724 million, $681 million, and $646 million, respectively. Five states—Vermont, South Dakota, Delaware, Wyoming, and North Dakota—each paid out $50 million or less to their employees.

The combination of increased payrolls and declining employment works out to a 9.6 percent increase in payroll per full-time equivalent employee—from $1,333 in October 1980 to $1,461 in October 1981. There was, however, a large variation in increases in payrolls per full-time equivalent employee among the states. Public employees in North Dakota averaged a 16.7 percent increase while those in Connecticut averaged only 0.4 percent. Other states in which increases in payrolls per employee were above the national average were: Louisiana (15.6 percent), New York (13.2 percent), Wyoming (13.1 percent), New Hampshire (12.5 percent), and Rhode Island (12.3 percent). Increases in payrolls per full-time equivalent employee were substantially below the national average (below 6 percent) in Utah, Minnesota, Massachusetts, Maine, Missouri, and Wisconsin.

The table below provides further details.

State and Local Government Employment[a] and Payrolls
Month of October, Selected Years 1951-1981

Year	Employment[a] (thousands)	Payroll (millions)	Employment[a] per 10,000 population	Payroll per employee[a]
1951	3,815	$ 1,008	248	$ 264
1956	4,687	1,566	280	334
1961	5,845	2,420	319	414
1966	7,263	3,798	378	523
1971	8,806	6,382	427	725
1976	10,206	10,359	475	1,015
1977	10,591	11,420	495	1,078
1978	10,724	12,139	492	1,132
1979	10,944	13,349	497	1,220
1980	11,047	14,730	488	1,334
1981	10,917	15,954	476	1,461

[a]Full-time equivalent basis.
Source: Bureau of the Census and Tax Foundation computations.

Special Units

(Continued from page 3)

local units combined. Special district spending in 1980 accounted for nearly 10 percent of local expenditures. Outstanding debt of the special districts came to $59.4 billion at the end of fiscal year 1980, accounting for almost 28 percent of all local debt, as compared to 21 percent of the total in 1972.

Direct spending by local governments came to $259.0 billion in fiscal 1980. Of this, municipalities accounted for $91.7 billion (35.4 percent), school districts for $80.8 billion (31.2 percent), counties for $53.1 billion (20.5 percent), special districts for $24.9 billion (9.6 percent), and towns and townships for $8.4 billion (3.3 percent).

Despite the increase in special districts, between 1942 and 1982, the total number of government units operating in the United States fell by almost one-half. This long-term decline was due primarily to consolidation of school districts, which were reduced from nearly 110,000 in 1942 to just over 15,000 in 1982. There have also been reductions in the numbers of counties and towns. Partly offsetting were increases of over 2,800 in municipalities and over 20,000 in special districts.

In total, 82,688 units of government operate in the United States, of which all but 51 are local. Over four-fifths of the local units have the power to levy property taxes.

The table on page 3 provides historical data on the number of government units by type for selected Census years since 1942, and state-by-state details for 1982.

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TAX FOUNDATION'S MONTHLY VOL. 27 NO. 1 JANUARY 1983

TAX·FEATURES

U.S. Economy Will Face "Window of Opportunity" in 1983

Two Oklahoma Congressmen told attendees at the Tax Foundation's annual conference and dinner that they consider 1983 a critical year in our national economic life.

Representative James R. Jones, Chairman of the House Budget Committee, in accepting the Tax Foundation's Distinguished Public Service Award, told those attending the dinner, "I consider it to be one of the most critical years in the economic history of the United States, certainly of this half of the twentieth century.

Senator David Boren, senior Senator from Oklahoma and a ranking member on the Senate Finance Committee, delivered essentially the same message to the luncheon. "If we can bring together the elements necessary to solve the problems that we face, we could put our economy on solid and stable footing," he said, "to begin a recovery that could be far more prolonged and, really, far more sound and meaningful than any recovery we have had coming out of an economic cycle for many years."

Both lawmakers focused on a number of things which would have to be done in order to take advantage of what Jones described as a "window of opportunity . . . the best chance we have in the next three years of putting together a bipartisan coalition." Both agreed that deficits must be reduced and the rate of growth of Federal spending must be slowed.

"Unless we bring down the deficit, we cannot sustain any kind of economic recovery, because sooner or later we will again have a clash between private sector borrowing and public sector borrowing," Boren told his audience. "We have tried to control it by slogans. We have tried to control it by theory. We have tried to control it by wishing it away," Jones charged. "But we really haven't tackled the way you control it: You cut spending. If necessary, you raise sufficient revenues to pay for the essential costs of government."

Emphasizing that "we have essentially concentrated on less than 20 percent of the entire budget" in cutting spending so far, Jones maintained that the Congress and the Administration would have to concentrate on the "remaining 80+ percent of that budget," including military expenditures, entitlement programs, and interest on the debt. Both agreed that Social Security was the largest part of the entitlements problem needing attention.

On the possible solutions, the speakers diverged somewhat. Boren rejected any "pump-priming" efforts, and called for a program which would have "a dramatic

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Consumption and Flat Taxes Weighed as Alternates to Income Tax System

Alternatives to the present Federal tax system served as the topics of discussion for Al Ullman and Robert E. Hall at the Tax Foundation's December 1 National Conference. Ullman, who served as Chairman of the House Ways and Means Committee from 1975 to 1981, discussed the consumption tax as a substitute for Federal corporate and personal income taxes.

He said that his experience on the Ways and Means Committee made it obvious to him that "major restructuring of the tax system was absolutely essential." He introduced legislation, in 1979 and again in 1980, "calling for extensive restructuring of our tax system, involving major reduction in income taxes and payroll taxes, offset dollar-for-dollar by a broadly based, flat-rate transaction tax on the product side." He did so, he explained, out of a firm belief that "the other components that balance growth cannot be achieved without developing a revenue system that produces adequate revenue to pay for government."

Ullman also spoke of the need for a new tax policy solution to turn around "the incentives in our capital system toward savings, investment, and productivity." He indicated that "only by a shift away from the income

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MARK YOUR CALENDAR

Tax Foundation's 35th National Conference and 46th Annual Dinner will be held this year on Wednesday, November 30, 1983, at the Plaza Hotel in New York City. Details will follow in future issues of *Monthly Tax Features*.

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Top Economist at Citibank Foresees "Surprisingly Strong" '83 Recovery

"Surprisingly strong recovery" for the first three to six months of 1983 was predicted by Leif H. Olsen, Chairman of the Economic Policy Committee of Citibank, at Tax Foundation's 34th National Conference in New York on December 1. Among the factors which would bring about a recovery "stronger than most people believe," Olsen listed:

- the decline in both short- and long-term interest rates;
- the rally in the stock and bond markets;
- the lowering of the prime rate;
- and the fall in the rate of inflation as measured by both the Consumer Price Index and the GNP price deflator.

All of these he called "contrary to expectations."

Olsen credited the Federal Reserve for restoring faith in "its credibility as a fighter of inflation" which, in turn, has created "an explosive increase in the willingness to lend and invest."

While the human mind tends to project the future in straight lines—"by an average trend"—Olsen argued, "That is not the way the world works." In actual experience, he said, "the economy fluctuates around the average trend, and sometimes fluctuates rather spectacularly." This is why the first or second quarters of a recovery often see "an explosive increase in money velocities, which lifts nominal GNP to levels far above the average trend that subsequently ensues," he noted.

"The economy fluctuates around the average trend, and sometimes fluctuates rather spectacularly."

The Citibank economist pointed out that personal consumption expenditures have been rising since January or February of 1982, observing that "the first half of 1983 could easily see real growth rates in the neighborhood of 5 percent or more, on average, and nominal GNP between 10 and 11 percent, with a single quarter, in fact, running well above that level."

"Current consumption is literally being financed with very long-term debt."

The velocity of money has been "running lower than we would expect," Olsen said, and as velocity goes back to a normal 3 or 4 percent annual rate, "nominal GNP will be very significantly increased." Because of this, velocity may overshoot, "as it often does during recoveries," and give us "those three to six months of much stronger recovery than is presently anticipated."

"Recovery is imminent, if not already under way."

However, Olsen said, the strong recovery will not mean that "this distress in our economy and globally" is going "to disappear in 6 to 12 months." Excess capacity and high unemployment will plague the economy "next summer and even a year from now."

Nor will recovery be "in a straight line. We will have a slowdown," he predicted, although he also expected "some further abatement of inflation" due to price-cutting in the early stages of the recovery.

The conduct of the Fed, in Olsen's opinion, remains crucial. "A return to the extreme volatility that we have experienced in 1978, 1979, and 1980 could wipe out those recent gains."

Other points made by Olsen during his keynote morning talk to the conference include:

- Real interest rates will average slightly—1 or 2 points—"higher in the years immediately ahead than they did during the decade of the 1970s."
- "The Federal sector share of GNP is likely to grow by, say, 2 percentage points over the next two years...Such an increase in the Federal share is manageable, but it isn't desirable."

On the Federal debt and spending policies, Olsen observed, "As long as the government is borrowing and, I might add, at the same time channeling funds, billions and billions of dollars, to consumers through various transfer and entitlement programs, it cannot be denied that current consumption is literally being financed with very long-term debt."

"We are," he continued, "under those circumstances, mortgaging the income of future taxpayers because we are unwilling to make the political adjustment that is required to reduce spending. The other option is raising taxes, which is neither politically viable nor economically wise."

Olsen ended his presentation by giving the U.S. economy in 1982 a mixed review: "Recovery is imminent, if not already under way. But there is no reason to believe that we have yet solved the long-term problem of declining productivity and the rise in secular trend of inflation."

(ULLMAN/HALL, from page 1)

side toward the product and consumption side" can such a turnaround be achieved.

Conceding that there are many ways of structuring a consumption package, the former Ways and Means Chairman recommended as "the most rational application of such a tax" establishment of a tax on transactions "involving the buying and selling of products or services." To avoid pyramiding, the tax "should be applied on the basis of added value," he said. Such a tax, he claimed, would be "easily assessed and collected."

While present deficits would prevent immediate relief, Ullman foresaw a more liberal system of deductions and dollar-for-dollar offsets permitting significant reductions in individual taxes as possible future benefits of the system. He also said the transactions tax could lead to eventual elimination of the corporate tax and "some relief on payroll taxes."

Among the other benefits of the broad-based consumption tax, Ullman listed:

- "Such a tax would be eligible under GATT for

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application as a border tax."

- "The new tax would reward efficiency and penalize inefficiency, reward savings rather than spending."
- "It would have real, indirect impacts on reducing interest rates and improving productivity."
- "We could go a long way toward eliminating the underground economy."
- "Business decisions could again be made on the basis of economic factors and expectations, rather than tax consequences."

Robert E. Hall, Professor of Economics at Stanford University and Senior Fellow at the Hoover Institution, explored the flat-rate tax proposal in his remarks. He called this "a tax system which provides higher revenue at lower tax rates . . . by the philosophy of broadening the tax base, providing a comprehensive yet well-worked-out tax, one that does not involve double taxation or the elimination of business deductions."

"You could think of our proposal," he said, "as simply a slightly more radical proposal of Ullman's proposal." He pointed out that, unlike the Ullman plan, his system abolished "the personal income tax" and "made the consumption tax progressive, rather than proportional to consumption."

Hall said that in designing his version of the flat-rate tax he followed a number of basic principles:

- "All income should be taxed exactly once."
- "All income should be taxed at a low rate."
- The "simplicity of the tax system" was a very important feature.

Under Hall's flat tax, a business "simply reports all its revenues and then deducts two things, under the value-added principle. One is purchases of goods upon which tax has already been paid . . . The other is that it deducts all of its investment spending. That is what makes it a consumption tax."

Although wages and salaries would also be deducted from the business tax, a departure from the value-added principle, Hall noted, "That income is taxed, under Form I, under the individual tax."

Regarding individual earners, Hall explained, "They would no longer have to file any of the complexities of the personal income tax. Instead, they would file the individual compensation tax, and they would pay tax only on their wage and salary income." Assets owned by an individual, if they produced income, would be taxed under the business tax section of his proposal, he said.

As the final point of his talk, Hall emphasized the need to eliminate the corporate income tax. "The Federal corporate income tax," he said, "is becoming like the absurd way that we taxed oil until very recently. We imposed a very large tax on oil production and used it to subsidize oil imports.

"Well, we are doing the same thing under the corporate income tax today. We are taxing a certain type of investment—entrepreneurial activities—more than anything else, and we are using it to subsidize tax shelters."

"Business decisions could again be made on the basis of economic factors and expectations, rather than tax consequences."

"We are taxing a certain type of investment—entrepreneurial activities—more than anything else, and we are using it to subsidize tax shelters."

THE FRONT BURNER

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"Playing to the Grandstands"

The Social Security System is in deep trouble, let no one doubt that. Having made this point, however, it is equally important to make several others.

First, there is not the slightest possibility that the President, the Congress, or the American public will permit the system to founder. The financial security of America's elderly is not in jeopardy. It is not true that younger citizens are now paying into a system which will not exist when their turn comes to retire.

Second, politicians of all colorations have taken a revenue problem that is marginal—that is, occurring at the margin, not at the heart of the system—and turned it into a vehicle for scoring political cheap shots off each other. This unconscionable grandstanding has deeply disturbed millions of Americans who are either currently benefiting from the system or paying into it in hope of future benefits.

Even the President's bipartisan Commission on Social Security Reform has gotten into the act, as members representing different interest groups play to their respective galleries. But then, how serious was the commission meant to be, other than to shelve the issue of Social Security until after the fall elections?

There are basically two solutions to the dilemma of Social Security: restructuring or tax increases. Singly or in tandem, it is here that the economics of the system will be straightened out. The only missing ingredients are sufficient integrity to leave politics out of the debate and sufficient courage to take the heat for making the painful decisions.

Previously there have been serious questions about the wisdom of putting Social Security off-budget, thus enabling yet another major element of public expenditure to disappear from view when the Federal budget comes under discussion. Now, second thoughts arise. If that is the price to pay for giving Americans the peace of mind regarding their later years to which they are entitled, then perhaps we should pay it.

Some things are just too important to be left to the politicians.

"There are basically two solutions to the dilemma of social security: restructuring or tax increases."

"We are back where we were last year if we do not come up with a bipartisan program."

(JONES/BOREN, from page 1)

impact—a $50-70-100 billion impact—on the size of the deficit." Such a major effort, he contended, is necessary to overcome what he called the "confidence factor," which causes investors to hold back if they believe that things are going to get worse.

To deliver this major impact on the economy, Boren supported a program which would be "some sort of variation on what Senator Hollings (Ernest F. Hollings, D-SC) supported last year." This would involve "postponement of the third year of the tax cut, a freeze on all cost-of-living increases, a freeze on all increases of government workers' salaries, and a freeze in all government discretionary spending," for one year. Boren said that the tax cut "should only be used as a bargaining mechanism, as the price paid in return for getting a total constraint on spending."

While Jones called for postponing the 1983 tax cut, he avoided mention of a freeze, asking instead for the elimination of the income tax indexing provision of the 1981 tax act, which is due to take effect in 1985.

Jones and Boren were equally in agreement that any effort to turn around the economy would have to be bipartisan. "We are back where we were last year," Boren charged, "if we do not come up with a program, a bipartisan program, that leaders of both parties, the White House and the Congress, can come together on."

Jones asserted that the solution could be done only by a "broad, centrist bipartisan coalition," maintaining "that is what we are trying to build right now." He faulted the leadership of both parties for staking out extreme positions. "The big problem we have, quite frankly," he said, "is that the two principal spokesmen for the two parties, Ronald Reagan and Tip O'Neill, have made a lot of statements, a lot of rhetoric, and it's going to be very difficult to get off those rhetorical positions. But they have got to be able to get off those positions in a way that saves face on both sides and allow this broad bipartisan coalition to be put together."

Conceding that his freeze proposal was not the only option, Boren also emphasized that any viable solution would have to be "generated in a joint agreement. It can't be either Democratic or Republican. It can't be something where one party pins the price tag for the pain on the other. It has to be something that we share."

Congressional Scorecard

The 97th Congress, Second Session, convened January 25, 1982, lasted 333 days (Senate met for 147, House for 140), recessed October 2 for campaigning and elections, reconvened November 29, and adjourned *sine die* December 23 (Senate) and December 21 (House).

Of 13 regular 1983 appropriations bills, Congress, at adjournment, had cleared 7 measures—Agriculture, District of Columbia, Housing and Urban Development-Independent Agencies, Interior, Military Construction, Transportation, and Legislative Branch. The remaining 6—Defense, Energy and Water Development, Foreign Aid, Labor-Health and Human Services-Education, State-Justice-Commerce-the Judiciary, and Treasury-Postal Service-General Government—with combined funding of $379 billion, are included in an emergency appropriations bill—continuing resolution—effective through fiscal 1983. This measure, signed by the President on December 21 (Public Law 97-377), replaced a prior continuing resolution (P.L. 97-276) which expired December 17, leaving the majority of the government technically out of funds for four days. A proposal to fund emergency jobs programs was dropped during the conference on the continuing resolution because of a possible veto.

At mid-session, Congress cleared legislation raising $98 billion in taxes over three years, authorizing airport development funds, limiting Medicare and Medicaid payments to hospitals and doctors, and extending unemployment compensation benefits for six to ten weeks.

An offsetting $30.7 billion reconciliation bill (P.L. 97-253) cleared August 18, freezing dairy price supports, delaying scheduled inflation-indexed Food Stamp adjustments, and tightening recipient eligibility standards. This was $180 billion short of the $209 billion in cuts included in the First Concurrent Budget Resolution, June 1982.

Toward better government Founded 1937

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SPECIAL REPORT

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Needed: More Fiscal Responsibility

By Maynard H. Waterfield

In the current national fiscal and economic policy debates, certain facts tend to get blotted out by the windstorms of political rhetoric:

- The Federal debt now exceeds $1.3 trillion.
- The Federal budget deficit, however measured, currently exceeds $110 billion and may grow even larger.
- Since 1970, Federal spending has more than tripled to a total of $728 billion in fiscal year 1982 and is estimated to top $760 billion in fiscal year 1983.
- If Federal spending continues to increase at the same average annual rate as it did from 1970 to 1982, expenditures could top the $1 trillion level by fiscal year 1985.

As dreary a prospect as this may seem, the problem runs even deeper. It is not just spending which is out of control. The budget system itself is seriously defective and badly in need of repair. The budget does not reveal the full scope of the government's financial transactions. Congressional budget actions, despite recent reforms, continue to be erratic and inefficient. Oversight and audit procedures in general are ineffective, with the result that there is inadequate accountability.

THE BUDGET SYSTEM

The budget system basically is composed of four steps, all interrelated and equally important:

1. **Budget formulation and presentation.** This is the responsibility of the President and Executive Branch. Based on reviews and consultations involving the Office of Management and Budget, Executive Branch agencies, and other advisers, the budget submitted early in each calendar year represents the President's financial plan and sets forth his program proposals and fiscal policy priorities.

2. **Action by Congress on the proposed budget.** During its item-by-item consideration, Congress can approve, disapprove, or modify the President's proposals, by eliminating or adding programs or making changes in requested funding levels. It may also affect the budget through actions on revenue measures.

3. **Execution and implementation of the budget as modified by Congress.** This is the responsibility of the President, primarily carried out, at his direction, through the Office of Management and Budget, which controls the distribution of appropriations and other spending authorizations through an apportionment system.

4. **Oversight and audit of performance.** Some of this review and audit is conducted in-house by the Federal agencies, but the principal oversight responsibility lies with the Congress and its agent, the General Accounting Office.

Over the years each of these steps or processes has developed weaknesses, with the result that efforts to exercise effective control of the budget are seriously impeded. In addition, this lack of control has contributed to the serious erosion of public comprehension of and confidence in budgetary and fiscal policy. Without public understanding, interest, and support, budgetary problems are not likely to be confronted effectively by the political leadership; and without more "truth in budgeting," that interest and support will be difficult to develop.

BUDGET FORMULATION

Any budget as huge as that of the Federal government—including about 1,100 accounts involving a variety of funding devices and encompassing thousands of programs, projects, and activities—is bound to be extremely complicated. However, the budget put before the Congress and the public each year is more complex than it needs to be. Much more important from the standpoint of the public, it is far less revealing than it should be. As large as the published budget totals are, accounting and other techniques camouflage many additional billions of Federal receipt and expenditure dollars.

For example, in recent years Congress has acted to establish a number of programs and entities which were placed in an "off-budget" status. Their receipts and expenditures are excluded from the unified budget totals, but the excess of their outlays over receipts is added to the unified budget deficit in determining how much public debt must be financed each year by borrowing or when adjustment is required in the statutory debt limitation. In fiscal year 1981, these off-budget entities had receipts of $40.9 billion and expenditures totaling $61.9 billion, with a resultant $21 billion deficit.

Other very sizable government transactions are included in regular unified budget totals only on a "netted out" basis, i.e., only the excess of outlays over receipts (or vice versa) is reported in the budget. Called public enterprise and trust revolving funds, a part of their activities is financed through other budget or off-budget accounts. In terms of the flow of funds to and from the public, public enterprise funds had receipts of $32.6 billion and outlays of $63.9 billion in fiscal 1981. On the same basis, trust revolving funds had receipts of $3.3 billion and outlays of $5.4 billion.

The unified budget presentation also includes substantial amounts of receipts, in budget parlance called "proprietary receipts from the public," which are not counted as budget receipts at all, but instead are offset against certain outlays. This represents a "wash" transaction, reducing both budget receipt and outlay totals. In fiscal year 1981, such offsetting receipts totaled $32.5 billion.

Certain other receipts from non-Federal sources, sometimes called "contributions," are similarly offset against certain outlays. Although data on such receipts had been provided in recent years by the Office of Management and Budget upon request, such a request for the 1981 total was denied.

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For that reason, the $8.9 billion of estimated non-Federal receipts in that year, provided earlier, is arbitrarily being used for the purpose of this analysis.

The latest unified budget presentation reported actual totals for the fiscal year 1981 as follows: budget receipts, $599.3 billion; budget outlays, $657.2 billion; the deficit, $57.9 billion. But when the transactions of off-budget entities are added in, the "netting out" process eliminated, and the indicated "offsetting" receipts are counted as receipts rather than as offsetting outlays, gross budget transactions, in terms of the flow of funds from and to the public, are 20-25 percent larger than the published totals, as reflected in the table below.

Gross Federal Budget Transactions with the Public
Fiscal Year 1981
(Billions of Dollars)

Item	Receipts	Outlays	Deficit
Unified budget totals	599.3	657.2	57.9
Off-budget entities	40.9	61.9	21.0
Public enterprise funds	32.6	63.9	31.3
Trust revolving funds	3.3	5.4	2.1
Offsetting-receipts:			
Proprietary receipts from the public	32.5	32.5	—
Receipts, non-Federal sources	8.9	8.9	—
Adjustments to avoid double counting:			
Net outlays, public enterprise funds		− 12.2	
Net receipts, trust revolving funds	− 2.2		− 10.0
Total, gross transactions with the public	715.3	817.6	102.3

Since the economy and the Federal budget are so interrelated, the budget should accurately and openly reflect the flow of funds from and to the public. This is not now the case. It is possible to assemble the above data through detailed examination of three separate budget documents, but only by means of a complex and time-consuming exercise.

RECOMMENDATION: Existing off-budget entities should be returned to on-budget status and their transactions fully reported in the unified budget; no new off-budget programs or activities should be created.

RECOMMENDATION: The present unified budget concept should be adjusted to reflect gross transactions with the public, with all receipts counted as such and all outlays fully reported; alternatively, a tabulation of the gross transactions should be included in each annual budget, with appropriate explanatory material.

Another element of the present budget presentation which deserves reevaluation involves the classification of a large percentage of budget outlays as "relatively uncontrollable." Each budget now includes a tabulation which, at least to the ordinary citizen, suggests that about three-fourths of total Federal spending is uncontrollable. True, examination of the explanatory material presented elsewhere in the budget reveals that the uncontrollability factor relates to short-term (annual) control, because program levels are already determined by provisions of law in effect at the time when the budget is being formulated.

This kind of outlay classification, however, tends to give credence to an impression that any spending restraint efforts must focus primarily on the one-fourth of the budget outlays which are classified as controllable. It is also sometimes seized upon by those opposing spending restraint, or who consistently demand cuts in national defense outlays (most of which are classified as relatively controllable) while vigorously resisting cutbacks in domestic benefit programs.

Under the present controllability concept, "relatively uncontrollable" budget outlays are grouped in two categories: open-ended programs or fixed costs, and outlays from prior-year contracts or obligations. Actually, only two types of outlays are susceptible to little or no discretionary control: net interest payments on the public debt and outlays required by contracts or obligations previously entered into. In fiscal year 1981, these represented about 27 percent of total outlays as reported in the unified budget.

All of the remaining "relatively uncontrollable" outlays are susceptible to varying degrees of control. For example, among the open-ended programs in fiscal 1981, those providing payments for individuals account for more than three-fourths of the total (or $294.5 billion). Some of these would seem to be more susceptible to short-term control than others. Programs involving contributions from the public—social security and other retirement programs, unemployment assistance, and to an extent medical care—are probably open to limited control. But to indicate that student aids, food and nutrition assistance, general revenue sharing, farm price supports, and certain other programs are in a similar status raises questions.

RECOMMENDATION: Consideration should be given to recasting the budget tabulation on controllability of outlays (table 17, page 9-46 in the 1983 budget), so as to present a grouping of the programs classified as "relatively uncontrollable" in a manner which would reflect the degree of susceptibility to control through the annual budget cycle.

Another problem with budget formulation involves the economic assumptions upon which budget receipt and outlay estimates are based. Some economic basis for these estimates obviously is essential; but if such assumptions are too far off the mark or are deliberately doctored to support a desired budget result, the estimates can be not only misleading but also meaningless. There appears to be no recourse except to rely on the good judgment of the budget formulators; but there is a responsibility on the part of budget analysts to challenge such assumptions if they appear to be unrealistic.

CONGRESSIONAL ACTION

Responsible and timely action by Congress on the President's budget proposals is a vital element of the budget system. However, the processes by which Congress acts are complicated and often not clearly understood, even by some Members of Congress.

No agency or program may be established or undertaken unless first authorized by act of Congress. This authorization process is the responsibility of the legislative committees of Congress, not the Appropriations or Budget committees. Most program authorizations, as contrasted with the establishment of a Federal agency, are provided for stated periods of time; and reauthorization is required at the expiration of that period. Some agency operations require annual authorizations, however. Some authorization measures include dollar "ceilings" on the amount which can be appropriated for the programs covered; others may simply authorize such sums as may be considered necessary.

RECOMMENDATION: Authorizing bills should, wherever possible, include a limit of no more than three years for any program, so as to provide opportunity for review of program performance and policy considerations once in each congressional term; and each authorization bill should specify a dollar limit for each year of program operation.

The next step is the consideration of the first budget resolution required under the 1974 budget act. This sets target totals for receipt, outlay, and spending authority actions. Then Congress turns to the appropriation process, during which time it may approve, increase, reduce, or reject the President's budget requests for spending authority.

What requires understanding, however, is that in this appropriating process, Congress does *not* in most instances act directly on the annual level of budget outlays. Even its later adoption of "binding" ceilings on functional and overall outlay totals in the final budget resolution is susceptible to revision at any point; and its effect on later Presidential expenditure decisions is questionable at best.

Budget (or spending) authority is provided by Congress in different forms—as appropriations, contract authority, or borrowing authority. Appropriations made available for current operations usually are available for obligation only during the current year (annual appropriations); some are provided for a longer period (multiple-year appropriations); some (no-year appropriations) remain available until expended. For certain programs, budget authority becomes available automatically, without requiring congressional action (permanent appropriations).

Beyond this, there is only an indirect relationship between the amounts of spending authority voted by Congress in any year and the actual budget outlays in that year. A significant portion of outlays in any given year is made under spending authority provided in prior years; by the same token, sizable amounts of the new authority provided by Congress in any given year are carried over for expenditure in subsequent years. As a result huge balances of spending authority are carried over from year to year. This complicates efforts to restrain expenditure growth. Example: at the close of fiscal year 1981, the balance of spending authority remaining available totaled $802.8 billion, about 35 percent of which was unobligated or uncommitted. Estimates indicate these balances will grow to $870 billion by the end of fiscal year 1983.

While Congress is extremely sensitive about its "power of the purse," the complexities of the procedures just outlined clearly impede its efforts to exercise effective budgetary control, except over a period of years, since it does not deal directly with scheduling of outlays.

RECOMMENDATION: In all bills providing new spending authority and in committee reports on such funding measures, Congress should include its estimate, or recommendation, on the outlay level it deems appropriate in the fiscal year for which the authority is provided for each appropriation item included in the bill.

One of the major flaws in Congress's handling of the budget is its repeated failure to complete action on budget bills prior to the start of the fiscal year. This has resulted in Congress resorting all too often to the "continuing resolution" device to provide agencies with temporary operating authority. This represents nothing short of abdication by the Congress of its budgetary responsibility and is, at best, a sloppy way to conduct the public's business.

One of the major objectives of the reforms instituted by the 1974 Congressional Budget Act was the establishment of a timetable designed to insure completion of Congress's budget actions prior to the start of a new fiscal year. A House Budget Committee staff report in 1978 described "rigorous adherence" to the timetable as essential to success of the budget process. However, after an encouraging start, Congress has recently returned to its old ways, resorting once again to the "continuing resolution" device. Agencies covered by such resolutions are forced to operate for months, on occasion, on the basis of neither the President's budget proposal nor a congressional decision thereon.

RECOMMENDATION: Whenever Congress fails to complete action on budget requests prior to the start of a given fiscal year, the President's budget recommendation shall automatically become effective in determining the level of operations for agencies and programs for which funding has not been provided.

EXECUTIVE IMPLEMENTATION

Traditionally, under the budget system an authorization by Congress has been regarded as a ceiling on the amount which could be appropriated, and an appropriation represented a ceiling on the amount which could be obligated and expended. It was then left to the President and Executive Branch to control the rate of spending and to achieve efficiencies and savings wherever possible. In recent years, however, this has become a very controversial part of the system.

There is a natural adversary relationship between Congress and the President in matters of budgetary policy. Basically, the President and his agency heads must accept the role and responsibilities of the Congress; and the Congress must understand and accept the need to permit the President leeway in his implementation of their budgetary actions. Put another way, Congress can and should have a role in establishment of budget policy; but it cannot administer day-to-day operations of the government and should not try.

The Congress is basically not an innovative body. Most program and policy initiatives originate in the Executive Branch. Where such initiatives are displeasing to Congress, it is often prone to overreact; doing so can not only hamstring the Executive implementation of the budget, but also make Congress's own job more difficult. This happened with the impoundment control provisions of the Congressional Budget and Impoundment Control Act of 1974.

Historically, the President has acted to impound (or reserve) funds appropriated by Congress, or to defer their obligation and expenditure, when changing conditions or other factors indicated such action was needed. Sometimes congressional complaints were voiced when this occurred, but it could be helpful in avoiding unnecessary or unwise spending. Impoundment was also consistent with the concept that an appropriation constituted a ceiling on the amount to be expended, not an irreversible mandate to spend.

During the Nixon Administration, however, there were obvious abuses. Impoundment was used to eliminate entire programs and agencies, on occasion, and to disregard the intent of the Congress. In a typical overreaction, Congress restricted the use of impoundments in a way which invaded the President's prerogatives in budget implementation. This

was a step toward making an appropriation approved by Congress a mandate to spend.

Those provisions were designed to restrict the President's use of two types of impoundments—rescissions and deferrals. If a President sought to rescind, i.e., cancel, spending authority voted by the Congress, he was required to send a message to Congress detailing the reasons. Unless his proposal was approved by *both* Houses within 45 days of "continuous session," the funds would then become available for obligation and expenditure. In the case of proposed deferrals—i.e., delays in obligating appropriated funds—such proposals could be disapproved by action of *either* House.

One problem with such constraints, particularly with respect to rescissions, is the time factor. The required 45 days of "continuous session" could stretch into months if there were congressional recesses or adjournments. Another is that the constraints do not take into account significant differences in the purposes of impoundment proposals. Some are simply to achieve efficiencies or savings and do not restrict programs or involve policy or priority issues. Others significantly affect programs and do involve policy issues and spending priorities.

In any event, there is need for reconsideration and adjustments in the impoundment restrictions imposed by Congress in 1974, so as not to impede Executive Branch opportunities to achieve greater efficiency and economy.

RECOMMENDATION: Where proposed impoundments do not involve policy or priority issues and are intended only to achieve savings, existing impoundment control provisions should be amended to eliminate requirements for Presidential reports and congressional approval.

RECOMMENDATION: Where proposed impoundments do involve policy or priority disputes between Congress and the President, existing impoundment control provisions should be changed to require that *both* Houses of Congress must act on a resolution of disapproval within 45 calendar days. In the absence of such action, the President's proposal would automatically take effect.

CONGRESSIONAL OVERSIGHT

Most of the major Federal agencies today have Inspectors General to help in rooting out fraud and abuse. The General Accounting Office in the Legislative Branch, in many cases, does an effective job of program review and audit, and submits numerous reports and recommendations to the Congress each year. Too often, however, these reports are ignored, or at least not acted upon, by Congress.

Beyond this, congressional oversight is weak and inconsistent. Congressional committees do conduct program reviews, but these usually occur at the time when reauthorization of a program is required. To contend that such reviews constitute tough, objective evaluations of program performance and achievement would be a gross overstatement. In too many cases, they provide simply a convenient vehicle for the program managers in the bureaucracy and the beneficiaries of the program to support its extension and, if possible, to secure its expansion and additional funding. As a result, Federal programs, once established, are seldom reduced and almost never terminated.

One of the greatest obstacles to effective oversight and audit of spending programs is that elected officials realize only too well that there are far greater political advantages in providing funds which benefit a variety of interest groups than there are in demanding strict accountability or exposing program weaknesses and failures or, for that matter, even in reducing budget deficits or achieving budget balance.

There are other problems. The growth propensities of Federal spending programs are largely buried in the myriad of details in a complex budget. They are seldom, if ever, examined in their entirety. Congress, in the appropriations process, relies heavily on usually unpublished justifications submitted by the spending agencies which tend to focus largely upon requested increments or increases rather than on basic program and performance. Still another problem is that most authorization legislation does not identify, except perhaps in the broadest terms, specific program objectives against which the Congress or its committees can later measure performance and make cost-effective evaluations.

RECOMMENDATION: The Office of Management and Budget, or alternatively the Congressional Budget Office, should be required to prepare and publish periodically an analysis indicating the growth in scope and cost of each major Federal spending program since its inception.

RECOMMENDATION: All measures authorizing new or reauthorizing existing programs should be required to include, in the bills themselves or in the committee reports thereon, clear and detailed statements of program objectives against which performance and cost-effectiveness can be measured.

CONCLUSION

The attainment of more responsible budgetary and fiscal policies and actions will require strong political leadership and the enforcement of strict standards of accountability. These, in turn, will require greater citizen understanding, interest, and support. More "truth in budgeting" is an essential ingredient to generating this public confidence and support. The recommendations in this report are offered in the hope of promoting that worthy cause.

ABOUT THE AUTHOR

MAYNARD H. WATERFIELD has been a student of Federal fiscal policy for nearly 50 years. He first came to Washington, D.C., from his native Ohio as an aid to Senator Hiram W. Johnson of California in 1934. In 1941, he joined the staff of Senator Harold H. Burton, who later became Supreme Court Justice, of Ohio. In 1945 he joined the Citizens National Committee as director of legislative research.

When the Committee merged with the Tax Foundation in 1948, Mr. Waterfield became the Foundation's director of Federal affairs and manager of its Washington office. His principal responsibility was to monitor and report on Federal budgetary and spending programs.

Mr. Waterfield served as editor of the Foundation's newsletter *Washington News* and directed the organization's annual appraisal of the presidential budget. He has had responsibility for a number of major studies published by the Foundation, the most recent of which, "The Congressional Budget Process at the Crossroads," he authored shortly after his retirement in 1980.

The views expressed in "Needed: More Fiscal Responsibility" are those of the author and not necessarily those of the Tax Foundation, Incorporated.

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TAX FOUNDATION'S MONTHLY VOL. 27, NO. 2 FEBRUARY-MARCH 1983

TAX·FEATURES

Drop in '83 U.S. Tax Load To Be Followed by Big Jump in '84

First the good news: The Federal tax burden in the current fiscal year (1983) will be $18.8 billion less than it was last year ($578.7 billion vs. $597.5 billion). Then the bad news: Next year, fiscal year 1984, Federal tax revenues will climb by $61.5 billion (10.6 percent) over 1983 levels. These are among the findings of Tax Foundation economists working with the data in the Administration's 1984 Budget as presented to Congress on January 31.

Not only is there good news and bad news, say Foundation researchers. There are also "winners" and "losers." The Federal tax burden falls unevenly upon the states. In contrast to Treasury calculations which show where taxes are collected, Tax Foundation economists have devised a formula to show where the ultimate tax burden rests. For example, excise taxes on tobacco products are collected mainly in a few southern states. But smokers in all states ultimately bear this burden.

Foundation researchers tally up winners and losers in two ways:

Total Taxes Paid

Predictably, states with the most people tend to pay the most total tax dollars. By this reckoning, winners, i.e., low-payers, are:

Vermont	$1.0 billion
South Dakota	$1.4 billion
Wyoming	$1.5 billion
North Dakota	$1.6 billion
Alaska	$1.6 billion

Citizens in the lowest-paying ten states will bear about 3 percent ($16.7 billion) of the total Federal tax burden in 1983. By contrast, citizens in the ten largest states will foot 58 percent ($332.4 billion) of the bill. These states are:

California	$68.4 billion
New York	$47.2 billion
Texas	$39.8 billion
Illinois	$33.6 billion
Pennsylvania	$29.6 billion
Ohio	$26.9 billion
Florida	$24.9 billion
Michigan	$23.3 billion
New Jersey	$23.2 billion
Massachusetts	$15.5 billion

Per Capita Taxes

On the other hand, per capita tax burdens tend to hit hardest in states with relatively high average income levels. Federal tax burdens for fiscal year 1983 are estimated to be lowest in:

Mississippi	$1,626
Arkansas	$1,746
South Carolina	$1,797
Vermont	$1,827
Alabama	$1,871

(Continued on page 2)

State-Local Taxes Jump 11% Breaking $1/4 Trillion Mark

State and local taxes—including unemployment compensation—broke the $1/4 trillion mark as they rose to hit $262.1 billion for fiscal year 1981. This $25.9 billion (11 percent) increase in fiscal 1981 marked the first time these levies had passed the quarter-trillion mark, according to Tax Foundation researchers.

State taxes make up $167.2 billion of that total, local taxes account for $94.9 billion, and unemployment

(Continued on page 4)

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State-local tax trends

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ERTA fades "Front Burner"

INSERT:
Reagan Budget 1984–1988

Per Capita State and Local Taxes

Number in parentheses indicates standing of states according to burden of state and local tax. Dollars equals per capita tax in fiscal year 1981. *(Tax Foundation map)*

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Estimated Total and Per Capita Federal Tax Burdens, by State
Fiscal Years 1982 – 1984[a]

State	Total burden (millions)			Per capita burden			State rank 1983	
	1982	1983	1984	1982	1983	1984	Total	Per capita
TOTAL	$597,472	$578,702	$640,203	$2,587	$2,482	$2,720	—	—
Alabama	7,583	7,395	8,214	1,929	1,871	2,069	25	47
Alaska	1,679	1,644	1,811	4,007	3,832	4,125	47	1
Arizona	6,612	6,400	7,096	2,328	2,206	2,394	28	36
Arkansas	4,137	4,031	4,496	1,798	1,746	1,943	33	50
California	70,717	68,402	75,737	2,885	2,744	2,987	1	10
Colorado	8,271	7,996	8,811	2,747	2,603	2,811	23	14
Connecticut	10,945	10,549	11,590	3,476	3,330	3,637	19	3
Delaware	1,711	1,656	1,827	2,852	2,751	3,024	46	9
Dist. of Col.	2,146	2,070	2,282	3,422	3,334	3,711	43	2
Florida	25,896	24,855	27,448	2,477	2,296	2,448	7	31
Georgia	11,819	11,506	12,747	2,096	2,009	2,192	16	38
Hawaii	2,596	2,519	2,794	2,622	2,511	2,753	38	19
Idaho	1,924	1,870	2,087	1,987	1,908	2,106	44	45
Illinois	34,788	33,626	37,120	3,029	2,921	3,217	4	5
Indiana	13,386	12,966	14,320	2,455	2,387	2,646	12	29
Iowa	7,358	7,099	7,891	2,546	2,467	2,755	26	23
Kansas	6,364	6,145	6,811	2,658	2,551	2,810	30	17
Kentucky	7,239	7,055	7,833	1,977	1,928	2,141	27	43
Louisiana	10,313	10,006	11,043	2,360	2,246	2,434	21	35
Maine	2,219	2,159	2,403	1,950	1,889	2,092	42	46
Maryland	12,478	12,096	13,331	2,909	2,796	3,057	14	8
Massachusetts	15,960	15,483	17,134	2,755	2,661	2,932	10	13
Michigan	24,032	23,326	25,798	2,621	2,557	2,844	8	16
Minnesota	10,761	10,432	11,563	2,623	2,536	2,803	20	18
Mississippi	4,238	4,135	4,601	1,671	1,626	1,805	32	51
Missouri	11,762	11,379	12,596	2,374	2,290	2,526	17	33
Montana	1,855	1,803	2,011	2,331	2,251	2,498	45	34
Nebraska	3,932	3,788	4,204	2,487	2,390	2,644	35	27
Nevada	2,550	2,469	2,724	2,917	2,704	2,855	39	11
New Hampshire	2,394	2,319	2,555	2,533	2,423	2,640	41	25
New Jersey	23,889	23,204	25,628	3,218	3,115	3,429	9	4
New Mexico	2,705	2,632	2,924	2,011	1,926	2,105	37	44
New York	48,886	47,162	52,247	2,774	2,672	2,957	2	12
North Carolina	12,148	11,840	13,134	2,025	1,954	2,146	15	42
North Dakota	1,655	1,594	1,772	2,504	2,401	2,652	48	26
Ohio	27,795	26,935	29,788	2,581	2,506	2,777	6	20
Oklahoma	7,651	7,400	8,192	2,433	2,309	2,508	24	30
Oregon	6,567	6,389	7,109	2,468	2,389	2,646	29	28
Pennsylvania	30,447	29,601	32,824	2,565	2,495	2,768	5	22
Rhode Island	2,458	2,397	2,666	2,571	2,495	2,762	40	21
South Carolina	5,946	5,810	6,451	1,861	1,797	1,973	31	49
South Dakota	1,397	1,350	1,508	2,045	1,985	2,230	50	40
Tennessee	9,664	9,406	10,421	2,090	2,029	2,241	22	37
Texas	41,233	39,802	43,769	2,732	2,561	2,736	3	15
Utah	2,994	2,923	3,255	1,928	1,827	1,974	36	48
Vermont	1,068	1,039	1,156	2,058	1,986	2,197	51	39
Virginia	13,945	13,529	14,927	2,545	2,440	2,661	11	24
Washington	12,540	12,178	13,456	2,938	2,807	3,053	13	7
West Virginia	3,970	3,874	4,296	2,033	1,984	2,200	34	41
Wisconsin	11,312	10,970	12,161	2,375	2,290	2,525	18	32
Wyoming	1,537	1,488	1,641	3,043	2,846	3,034	49	6

[a]Data for 1982 are actual; 1983 and 1984 are estimated.

Source: U.S. total taxes as shown in the Federal budget submitted January 1983; computations of total and per capita burdens by state were made by Tax Foundation.

Monthly Tax Features

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(FEDERAL TAX BURDEN, from page 1)

High payers are the people living in the following ten states:

Alaska	$3,832
District of Columbia	$3,334
Connecticut	$3,330
New Jersey	$3,115
Illinois	$2,921
Wyoming	$2,846
Washington	$2,807
Maryland	$2,796
Delaware	$2,751
California	$2,744

Nationwide, the average per capita Federal tax burden for 1983 is estimated at $2,482, 4.1 percent lower than last year; but it is projected to climb 9.6 percent and hit $2,720 in 1984.

Further details and state-by-state breakdowns are available from Tax Foundation.

Tax Hikes in 23 States Will Bring in $4 Billion From Non-Property Levies

State tax revenues will jump more than $4 billion above the amounts that would have been raised under tax rates prevailing on January 1, 1982, according to estimates by Tax Foundation economists. The increase reflects changes in nonproperty taxes put into effect in 23 states during the last calendar year.

Between January 1, 1982 and January 1, 1983, there were 43 rate increases in the 233 separate nonproperty tax levies, Foundation researchers say. Almost one out of every five major state tax rates increased last year.

Individual income taxes were hiked in ten states; general sales and cigarette taxes each, in nine states; motor fuels taxes, in eight states; and corporate income taxes climbed in seven states. General sales and use taxes, levied by forty-five states, continue to be the single most productive revenue source.

In 27 states with sales taxes, localities may also levy their own sales tax. New York City's combined 8.25 percent state-local sales tax is the highest in the nation. Oklahoma's 2 percent state rate is the lowest, although local taxes imposed on top of this rate range up to 3 percent. In fiscal year 1981, state general sales taxes accounted for 31.0 percent of all state tax collections, bringing in $46.4 billion in revenues.

Income taxes, both individual and corporate, continue to be major revenue raisers for states, second only to sales taxes. Only five states—Nevada, South Dakota, Texas, Washington, and Wyoming—continue to dispense with corporate and personal income tax revenues. Alaska and Florida have no individual income tax, but do impose corporate income taxes. (Connecticut, New Hampshire, and Tennessee have very narrowly based individual income taxes.) Individual income taxes composed 27.3 percent of all state tax revenues, while corporate income taxes accounted for 9.4 percent of those revenues, a slight shift over last year in the direction of individual income taxes. The total take from income taxes by states in fiscal year 1981 amounted to $55.0 billion, up $0.6 billion over the preceding year.

(Continued on page 4)

ERTA's Tax Cuts Slowly Fade Away

The second session of the 97th Congress chopped away at the 1981 tax act (ERTA), and the result was TEFRA, which repealed about half the business-oriented provisions of the 1981 act. The first session of the new 98th Congress will keep on whittling. And the result, rather than carving a fiscal Mount Rushmore, will more likely resemble the infamous Chinese Death of 1,000 Cuts.

ERTA had a three-fold core:

- phased in 25 percent reduction in the marginal rates on individual income;
- indexation of future taxes to the rate of inflation; and
- significant reform in the tax treatment of capital depreciation.

TEFRA repealed significant elements of the corporate tax changes and imposed much stronger reporting and withholding requirements on corporations and individuals.

December 1982 brought the Highway Revenue Act of 1982, hiking the Federal excise tax on gasoline from 4¢ a gallon to 9¢ a gallon, effective April 1983. Social Security payroll tax hikes already written into law will have significant revenue impact in fiscal years 1982-86, regardless of the fate of the fragile compromise now working its way through the legislative gristmill.

(Continued on page 4)

"Social Security payroll tax hikes already written into law will have significant revenue impact in fiscal years 1982-1986."

THE FRONT BURNER

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"Déjà Vu"

If you feel an eerie sense of the familiar as the 1983 tax debate gets underway, don't be surprised. We have been down this path before—last year.

What the first year of the 98th Congress promises to give us is TEFRA revisited. I suppose that's acceptable, if the goal is raising money as distinct from intelligent tax policy.

ERTA, the 1981 act, presented essentially three policy elements: a 25 percent across-the-board personal tax cut phased in over three years; indexing of the tax system to prevent the automatic revenue increase caused by inflation; and business tax provisions targeted on investment, R&D, and capital formation.

TEFRA, 1982's act, began the dismantling of this carefully thought out tax reduction program, making not even the slightest nod in the direction of rational tax policy. The goal was simple: to raise $98 billion. The goal was achieved.

As the Budget for Fiscal Year 1984 enters the Congressional gristmill, deficits in the $180-200 billion range are being touted. Can there be any serious doubt that we will soon see an assault on what remains of ERTA?

The third year of the personal tax cut is already being challenged. Indexing has come under heavy fire. It is distressing to see indexing castigated as some sort of irresponsible give-away, when all it does is prevent the Federal government from receiving an unlegislated revenue windfall every time inflation rises.

One skirmish to reverse the inroads of Congress on ERTA deserves an aside. A drive has been mounted to repeal the withholding requirements for income from dividends and interest. The response on the Hill has been petty vindictiveness. Those who dare question the omniscience of the taxwriters are threatened with hints of other, harsher measures.

Such small-mindedness has not characterized tax policy in the past. It ought not be the response to those exercising their right to speak out on legislation that affects them.

Finally, there is talk of more taxes on the corporate sector. Since TEFRA took away about half the business-oriented provisions of ERTA, it is hard to imagine that anything will be left by the time this year's revenue raid on the private sector ends.

These "policies" will, of course, have absolutely no effect on the long-term deficiencies of the social security system (assuming the fragile compromise for solving the short-term problems survives). They will also not address the continued growth of Federal spending and the politicians' unwillingness to deal with the thorny issue of so-called entitlements and indexed benefits. They will also not make any kind of dent in the $130 billion in spending cuts that were promised, but not delivered, by Congress last year.

As the songwriter put it, "It seems to me I've heard that song before." And it is indeed a sad song. I can't help thinking there must be a better way to formulate tax policy. It is inconceivable that there could be a worse one.

"It is distressing to see indexing castigated as some sort of irresponsible give-away."

"It is hard to imagine that anything will be left by the time this year's revenue raid on the private sector ends."

"Despite the erosion of ERTA last year, the marginal rate cuts of the 1981 tax act survive as the dominant policy change of this decade."

(ERTA, from page 3)

Finally, the unlegislated tax increase of inflation-caused "bracket-creep" will take another bite from American incomes.

The table below shows the change in aggregate receipts for each fiscal year from each of these sources, through 1986.

Despite the erosion of ERTA last year, the marginal rate cuts of the 1981 tax act survive as the dominant policy change of this decade. This will no longer be true, however, if the indexing of individual income tax brackets for inflation is repealed. Naturally, continued slowing of inflation lessens the impact of the indexing provision.

The Social Security hikes already on the books and proposals for more increase in later years will erode ERTA's benefit further. It is conceivable that ERTA will be like the Cheshire cat of Lewis Carroll's Wonderland —nothing but a smile, with only the structural reform removing some of the bias against savings in the individual income tax structure through lower marginal rates and expanded IRA's.

Effect on Budget Receipts of Enacted Legislation and "Bracket-Creep" by Source

Fiscal Years 1982 - 1986

(Billions of dollars)

Source	1982	1983	1984	1985	1986	1982–86
Economic Recovery Tax Act	-35.6	-82.6	-130.3	-158.2	-202.3	-609.0
Tax Equity and Fiscal Responsibility Act		17.3	38.3	42.2	52.1	149.9
Highway Revenue Act of 1982		1.7	3.8	3.9	3.9	13.2
Social Security amendments	1.9	5.3	8.7	20.2	30.5	66.6
	-33.7	-58.3	-79.5	-91.9	-115.8	-379.3
Inflation-induced[a] revenue increases	15.0	22.7	31.8	—	—	69.5
Net change from above sources	-18.7	-35.5	-47.7	-89.9	-115.8	-309.8

[a] Represents gain in individual income tax receipts only, due solely to the cumulative effect of inflation moving taxpayers into higher marginal brackets. Indexing of individual taxes, effective 1/1/85, ends "bracket creep."

Source: Office of Management and Budget, and Tax Foundation calculations.

(STATE-LOCAL TAXES, from page 1)

compensation levies, levied primarily by the states, supply the remaining $17.6 billion.

The jump from 1980 to 1981 was the largest percentage increase in four years (collections rose by 11.1 percent in 1977) and was slightly above the 10.4 percent annual average for the period 1971-1981.

Tax Foundation economists draw the following comparisons: From 1971-81, state-local taxes rose 169 percent. Federal tax collections rose 217 percent (12.2 percent per year); population, 11.9 percent (1.1 percent per year); personal income, 178 percent (10.8 percent per year); and prices, 125 percent (8.4 percent annually).

When unemployment taxes are removed from the totals, general state-local tax collections still rose 9.4 percent from 1980 to 1981, up $21.0 billion, for a total of $244.5 billion. During the 1971-81 decade, such levies rose by 157.5 percent, or at an average annual rate of 9.9 percent.

Throughout the decade, state-level taxes outpaced local collections, jumping from 54 percent of the take in 1971 to 61 percent in 1981, say Foundation economists.

State and local general tax collections (not counting unemployment compensation) averaged $1,079 per capita in fiscal 1981—almost two-and-a-half times the $460 per capita level prevailing in 1971. This growth, however, lagged behind increases in personal income; nationwide, state-local general tax collections dropped from $119 to $113 for every $1,000 of personal income, a 5 percent decrease.

Details appear in the map on page 1. For further information, contact Tax Foundation.

(STATE TAX HIKES, from page 2)

Every state in the Union taxes gasoline. In fiscal 1981, $9.7 billion—6.5 percent of the total tax take—flowed to state coffers from motor fuels taxes.

Cigarette taxes contributed 2.6 percent of the total tax revenues garnered by the states in fiscal 1981, a total of $3.9 billion.

Further details and a table showing major taxes and rates prevailing in the states are available from Tax Foundation.

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The Reagan Budget: 1984-1988

By Elsie M. Watters
Director of Research, Tax Foundation, Incorporated

Scrutiny of the 1984 budget suggests strongly that the problem of bringing Federal fiscal affairs under control has been vastly underestimated in the past, not only by the Reagan Administration, but by fiscal economists at large. On the outlays side, two factors seem dominant. As the budget correctly points out, the United States has for many years lagged behind most major industrial nations in its social insurance programs. Only now, in their catching up and maturation stage, is the impact of these programs and their powerful growth momentum being fully experienced. There is also no question that what might have been a normal buildup in national defense needs was allowed to fall far behind during the 1970s.

The Administration's efforts to control expenditure growth seem heroic in some respects. After Congress approved substantial amounts of the President's recommended cuts in the 1982 and 1983 budgets, the 1984 budget is proposing further reductions from current policy projections, totaling $348 billion through 1988. Certainly not all of the proposals will be approved by Congress. Even if they were, the share of government outlays in the economy would grow about as rapidly in the 1980s as it did in the 1970s.

Two years ago the Administration predicted—now admittedly with excessive optimism—that by fiscal 1984 outlays would be brought down to 19.3% of Gross National Product (GNP). Outlays for the 1980-1988 period, as proposed in the 1984 budget, would climb by 3.1% a year when adjusted for general inflation (consumer price index), only fractionally less than the 3.3% rise on a similar basis that occurred from 1970 to 1980. Again assuming all the proposals are approved, and that the Administration's economic assumptions are sufficiently accurate, projected outlays by 1988 would remain at 23.2% of GNP, down by just two percentage points from the peacetime record of 25.2% estimated for 1983 and well above the share claimed during the 1970s generally.

Similarly, the revenue outlook provides little grounds for optimism in reducing the size of the government sector relative to the economy as a whole. Under the Administration's proposals, including the standby taxes, budget receipts, adjusted for general inflation, would rise by an annual average of 3.0% from 1980 to 1988, higher than the 2.4% a year growth from 1970 to 1980. As a consequence, Federal budget receipts would claim a 20.6% share of GNP in 1988, higher than in any year of the 1970s and above their 20.1% share in 1980.

None of this is to gainsay the obvious fact that, absent policy initiatives of the sort the Reagan Administration has put forth, both receipts and outlays would claim an even more substantial share of the economy in the 1980s than is projected in the new budget.

For those concerned about the high claims of the government sector on the economy, there seems to be but one ray of hope, apart from further massive spending reductions, a course not now viewed as politically realistic: better performance of the overall economy than the Administration and many others now forecast for the 1980s. The Administration says that real economic growth would have to be about 5.1% annually (1.33% higher than its current estimate of 3.8%) in order to achieve "full employment" and balance the budget by 1988, even if Congress approves the President's package of "sweeping" policy changes.

Behind these best-case projections are some major unanswered questions. Technical experts disagree on what the productive capacity of the nation is or will be, on what levels of employment and other resource utilization will produce "full" or "high" employment, and on how these and other factors may combine to reduce or eliminate the so-called structural deficits. The Administration's projections of the economy's potential and of the consequent budget levels during the 1980s, while perhaps realistic, are not encouraging. They are, however, "educated guesses," as valid as anyone else's reading of the fiscal tea leaves.

FOUR MAJOR THEMES

In his budget message on January 31, President Ronald W. Reagan reiterated the four themes emphasized in his two previous budgets: the Administration's desire to limit tax burdens, reduce the growth of overall Federal spending, diminish Federal regulatory burdens, and support a monetary policy that would bring inflation under control. While reaffirming these aims, the President's message on the 1984 budget reflected poignant concern over a somewhat different aspect of budget policy: the large and continuously rising deficits that are foreseen in the 1980s in the absence of major policy changes.

For fiscal year 1984, the budget proposes outlays of $848.5 billion, a nominal increase of $43.3 billion or 5.3% over the currently estimated $805.2 billion in 1983. Receipts are put at $659.7 billion in 1984, an increase of $62.2 billion or 10.4% from the $597.5 billion collected in the current fiscal year. The budget deficit would be $188.8 billion in 1984, down by $18.9 billion from the $207.7 billion now estimated for 1983.

The indicated deficits this year and next would raise gross Federal debt from $1.147 trillion at the end of fiscal 1982 to $1.606 trillion by September 30, 1984, or by 40%. To finance the budget deficit and the off-budget deficit (estimated at $14 billion in 1984), the Treasury expects to borrow from the public $215 billion in 1983 and $203 billion in 1984. (Borrowing in 1982 came to just under $135 billion.) According to the budget, the proposed deficits will absorb 135% of net private savings in 1983 and 101% in 1984.

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In presenting the 1984 budget, the Administration also proposed significant changes in the 1983 budget from the amounts shown in its mid-session review last July 30. Outlays in 1983 would be $43.7 billion higher than estimated at that time, revenues $49.0 billion lower, and the deficit $92.7 billion higher. The revisions reflect a change in the government's economic forecast, re-estimates of spending, actions of the 97th Congress, supplemental requests, and rescission proposals.

DEPARTURES FROM TRADITIONAL BUDGETS

The emphasis in the 1984 budget differs in several ways from what has come to be expected when a new budget is put forth. In the 1984 budget, the Administration:

- ☐ focuses more intently on changes over the long run, 1984-1988, than on the immediately forthcoming fiscal year;
- ☐ emphasizes the comparison of recommended changes against "current services" or "current policy" baselines more strongly than changes over time; the baselines reflect what would happen to spending, revenue, and deficits if there were no change in current law, generally including adjustments for inflation;
- ☐ offers a candid discussion of economic assumptions and their effects on the budget;
- ☐ accepts blame for its own previous forecasting errors and accuses governments over the past ten years of presenting overly optimistic and misleading forecasts that have "undermined public confidence in the Government's ability to administer and control . . . its responsibilities";
- ☐ "apologizes," in a sense, for the failure of its two previous budgets to reach the desired goals and explains why this happened;
- ☐ defends its own economic projections in the 1984 budget as realistic and prudent, and not—as some critics charge—either overly pessimistic or excessively optimistic;
- ☐ presents a grim outlook for outlays and receipts under which the budget deficit would rise without interruption, reaching $315 billion by 1988 absent policy changes;
- ☐ attributes a rising share of budgetary imbalance to "structural deficits"—those that would occur even if the economy were operating at or near full capacity;
- ☐ proposes what the President referred to as "a sweeping set of fiscal policy changes designed to reduce substantially the mounting Federal deficits that threaten the renewal of economic growth."

ECONOMIC ASSUMPTIONS

The Administration's underlying economic assumptions represent a sharp turn-around from what proved to be an excessively optimistic outlook presented in the two previous budgets. For the calendar year 1983 as a whole, the assumption is that real GNP will grow only 1.4% over the year 1982. For the 1983-1988 period, real GNP growth is projected to average 3.8% annually. Price increases are seen as falling gradually, averaging 4.8% a year over the six years. The unemployment rate and interest rates are depicted as declining throughout the period.

The real growth assumption of the Administration is defended against critics who argue that it is too high or too low. Reviewing the pros and cons, the budget concludes, ". . . it seems reasonable to assert that the momentum of a decade-long trend of economic weakness and stagnation argues against a record-breaking rate of recovery of 5% or more, represented by the optimistic case. However, a number of significant economic policy changes suggest that real growth in the United States during the next several years will rise above the slow growth trend of the 1970s and regain its typical postwar six-year recovery rate of 4%, rather than the pessimistic 3% growth case."

STRUCTURAL DEFICITS

The "structural deficit" represents the difference between budget receipts and outlays under "high" employment. The Administration defines high employment at a level of about 6¼% unemployment. The remainder of the deficit—that resulting from lower receipts and higher outlays (unemployment benefits, food stamps, etc.) in a weak economy—is labeled "cyclical." According to the Administration's estimates, based on current services, nearly three-fourths of the projected 1984 deficit and 97% of that remaining in 1988 are structural. Moreover, the structural deficit, it is claimed, would double in size between 1983 and 1988 without major policy changes.

The Administration attributes the structural deficits to "the effects of cumulative economic trends and fiscal policy decisions stretching over a decade." The budget describes the "ballooning" of the social insurance (called "social contract") programs and other entitlements, pointing out that between 1970 and 1981, they rose from 6.0% to 10.1% of GNP. At the same time defense spending was allowed to decline from 8.3% to 5.5% of GNP, while most other components of the budget increased their GNP share somewhat. Admitting its failure to solve this problem in the past two years, the Administration faults the unanticipated economic setback that led to a lower long-term GNP path and higher interest outlays than originally planned, and says that the policy changes made have been more successful in reducing the tax claim on GNP and less successful in cutting the non-defense spending claim than initially projected.

It seems worth noting that the structural deficits now foreseen by government and private fiscal experts represent the reverse of the "fiscal dividend" of the 1960s. At that time it was claimed that under existing laws budget receipts would tend to rise faster than outlays and to exceed outlays at full employment. The resulting "fiscal dividend," or what in today's terminology might be referred to as a "structural surplus," it was held, would choke off economic expansion and create various other problems. (Thanks to government policies that managed to claim them in advance, the fiscal dividends or structural surpluses of the 1960s remained illusory.)

BUDGET RECOMMENDATIONS TO CLOSE THE STRUCTURAL DEFICIT

To reduce the projected deficits, the President put forth a four-part plan that included a spending freeze on some programs, measures to control the growth of the so-called "uncontrollable" spending programs, some savings in the defense budget, and a standby tax increase to become effective in fiscal 1986 under certain conditions. The budget describes each of the recommendations in some detail. The scope of this report precludes full discussion, but some highlights can be cited.

1. **Spending and Cost-of-Living Allowances (COLA) Freeze.** Savings from these proposals are estimated at $19 billion in 1984 and $164 billion in 1984-1988. In 1984, there would be no pay increases for Federal employees or pension increases for former employees. There would be a six-month deferral of COLA adjustments for recipients of social security, supplemental security income, railroad retirement, veterans' compensation, food stamps, and child nutrition. In addition, aggregate discretionary spending would be frozen at the 1983 level, with selective increases or reductions in the components, according to the Administration's priorities. The plan also includes a farm price support freeze and reform plan.

2. **Structural reforms of "uncontrollable" programs.** The changes would affect social security, Federal employee retirement, health care, and means-tested benefit programs. Estimated savings are $19 billion in 1984 and $228 billion over the next five years.

The budget recommendations embody the proposals agreed upon by the bipartisan National Commission on Social Security and endorsed by congressional leaders and the President. Briefly, the plan includes: a six-month COLA freeze; accelerating scheduled payroll tax increases in 1984 and 1988; inclusion of 50% of social security benefits in the income tax base for taxpayers above specified income levels; extension of coverage to new Federal employees and all uncovered nonprofit employees; prohibition on future withdrawals of state and local governments; increasing the self-employment tax rate and allowing deductibility of half the payment; and requiring a lump-sum payment of Federal obligations for past military service credits.

Extensive revisions would be made in the Federal civilian retirement system in an effort to cut long-run costs from a current 35% of payroll to 22% of payroll. Employee contributions would be raised from 7% to 11% of salary; Postal Service and District of Columbia would be required to fund their fair share of costs for their employees; and a number of annuity reforms would be implemented.

The health care proposals would reduce costs of medicare and medicaid, primarily through a reform of hospital reimbursement to eliminate cost-plus payments; and would revise the health insurance coverage provided by employers, putting a $175-a-month cap on tax-free exclusion of employer health benefit plans.

3. **National Defense.** "Maintenance of the defense buildup" would be achieved, while realizing savings from lower inflation, the 1984 pay freeze, and other "program economies," for current services reductions totaling $55 billion in 1984-1988.

4. **Standby tax plan.** In addition to revenue initiatives under social security, Federal retirement systems, and health insurance, the President proposed a contingency tax plan, or standby tax, to become effective on October 1, 1985. Labeled a "deficit insurance policy," the taxes would consist of a 5% surcharge on individual and corporate income tax liability and an excise tax on domestic and imported oil that would raise revenues of about $5 a barrel. The plan would go into effect only if three conditions are met: Congress adopts the Administration's deficit reduction measures; the unified budget deficit for fiscal 1986 is forecasted by the Administration on July 1, 1985 to be above 2.5% of GNP; and on July 1, 1985 the economy is growing. The taxes would raise an estimated $46.0 billion in 1986 and would remain in effect for up to 36 months.

The Administration apparently views the standby tax proposal as a way of forestalling efforts to repeal the third year of the 1981 tax cuts and tax indexing, scheduled to begin in 1985. In presenting the plan, the President said that the Administration would continue to study ways to simplify the tax code. "At the same time, however," he said, "I will oppose any efforts to undo the basic tax reform we have already enacted—including the 10% tax break coming to taxpayers this July and the tax indexing. . . ."

Table 1 compares the budget recommendations with current services baselines for fiscal years 1984 through 1988. By reductions in outlays of $348 billion and increases in receipts of $234 billion, the deficit would be reduced by amounts beginning at $46 billion in fiscal 1984, rising to $190 billion by 1988. As a share of GNP, budget recommendations call for outlays declining to 23.2% of GNP by 1988, instead of 25.4% under current services. Receipts would rise to 20.6%, instead of 18.9%, of GNP under current services, and the deficit would drop from 6.4% of GNP under the current services estimates to 2.6%.

Table 1

Comparison of Budget Recommendations with Current Services Baseline

(In billions)

	1984	1985	1986	1987	1988
Outlays					
Current services	$ 897	$ 981	$1,065	$1,157	$1,242
Proposed savings	− 35	− 52	− 66	− 89	− 106
Proposed outlays	863	929	999	1,068	1,136
Receipts					
Current services	649	713	781	849	927
Proposed changes*	11	11	61	67	84
Proposed receipts	660	724	842	916	1,010
Deficit					
Current services	− 249	− 267	− 284	− 308	− 315
Proposed reductions	46	63	127	156	190
Total deficit	− 203	− 205	− 157	− 152	− 126
On-budget deficit	− 189	− 194	− 148	− 142	− 117

*Includes contingency tax plan.
Source: Office of Management and Budget.

OTHER SPENDING HIGHLIGHTS

For 1984, the proposed 5.4% increase in outlays is smaller than any yearly rise that has occurred in Federal spending since 1971. It is less than half the 11.8% average annual rate of increase in 1980-1983 and far below the 17.5% jump in

fiscal 1980. With adjustment for inflation, the 1984 proposal reflects a zero growth rate. If this materializes, 1984 would be the first year since 1970 in which there was no real increase in Federal outlays.

As was to be expected, proposed spending for national defense would increase substantially in 1984–by 14.2% in nominal dollars and 10.0% in constant dollars; in 1980-1983 the average annual nominal rise was 16.5%. Net interest would also rise rapidly, by 16.1% in 1984 as compared to 12.5% on average in 1980-1983. In the aggregate, non-interest, non-defense outlays in 1984 would decline by 2.2% in nominal dollars and 5.3% in real terms, similar to the trend in the last three years.

The "freeze" in overall spending in 1984 notwithstanding, there would be a varied pattern of ups and downs in different functional categories under the budget plan. Table 2 presents, for 14 major categories, the proposed 1984 changes compared with 1983 outlays as well as with estimated current services levels in 1984. Also shown are the average annual proposed changes over the next five years. For all functions the average yearly change for the period is 7% in nominal dollars.

Spending categories for which the President proposes major increases in 1984 over 1983, in addition to national defense and interest, include: international affairs, transportation, health, social security, and veterans' benefits. Major reductions are proposed for energy, natural resources/environment, commerce/housing credit, education/employment/social services, and income security (except social security).

Federal grants-in-aid to state and local governments are projected as rising by 3.0% a year in nominal dollars from 1983 to 1986. The Administration has scaled back the controversial "New Federalism" proposal it announced in 1982, and promises to offer a revised proposal in early 1983.

OTHER REVENUE HIGHLIGHTS

In the current fiscal year, budget receipts are expected to decline from 1982 by about $20 billion, or 3%, as a result of the 1981 tax cuts and the recession. In 1984, receipts are projected to rise by $60 billion, 10%, almost entirely as a result of economic improvement; $11 billion of the increase reflects revenue initiatives in the reform plan. A similar rise of about 10% is projected for 1985. However, if the standby tax package were approved, as recommended by the Administration, the rate of increase would move up to almost 12% in the years 1985-1988. Over the five years, 1983-1988, receipts would grow about 69%, or just over 11% annually.

Table 3
Proposed Budget Receipts by Source
(In billions)

Source	1982 actual	Estimate 1983	1984	1985	1986
Individual income taxes	$297.7	$285.2	$295.6	$317.9	$358.6
Corporate income taxes	49.2	35.3	51.8	60.5	74.0
Social insurance taxes and contributions	201.5	210.3	242.9	275.5	304.9
Excise taxes	36.3	37.3	40.4	40.8	74.8
Estate and gift taxes	8.0	6.1	5.9	5.6	5.0
Customs duties	8.9	8.8	9.1	9.4	9.7
Miscellaneous receipts	16.2	14.5	14.0	14.5	14.8
Total, budget receipts	617.8	597.5	659.7	724.3	841.9
Exhibit: receipts under existing legislation	617.8	597.5	648.5	713.1	780.6

Source: Office of Management and Budget.

Table 3 depicts budget receipts by type of tax as projected through 1986. The largest percentage gains are shown in excise taxes (including the standby oil tax) of 106%; social insurance taxes, 51%; corporate income taxes, 50%; and individual income taxes, 20%.

The proposed policy changes account for $61.3 billion of the indicated rise in receipts in 1986. The major portions of the increase would come from the contingency tax plan ($46 billion); changes in social security payroll taxes ($8.9 billion); taxation of employer paid health insurance premiums ($6.0 billion); and higher Federal employee contributions to their pension system ($2.1 billion). These increases would be slightly offset by new tax incentives proposed in the 1984 budget that would provide a total of $1.9 billion in tax reductions. Included are enterprise zone tax incentives (which would cost $800 million in lost revenues in 1986); tuition tax credits ($800 million); educational savings accounts for higher education ($200 million); a jobs tax credit ($100 million); and others of lesser cost.

Table 2
Proposed Changes in Budget Outlays by Function
(Dollar amounts in billions)

Function	Amount of change 1983-1984	Percent change in 1984 compared to 1983 outlays	Percent change in 1984 compared to Current services	Average annual percent change 1983-1988
Major increases in 1984				
National defense	$30.5	14	−3	12
International affairs	1.3	11	1	1
Transportation	3.2	15	−4	5
Health	8.2	10	−2	10
Social security	9.9	6	−2	7
Veterans' benefits	1.3	5	−2	3
Net interest	14.3	16	−2	9
Major decreases in 1984				
Energy	$−1.2	−27	−20	−7
Natural resources, environment	−2.3	−19	−12	−8
Agriculture	−9.0	−43	−21	−14
Commerce/housing credit	−1.5	−79	−81	N/C
Education/employment/social services	−1.4	−5	−7	−1
Income security (excluding social security)	−10.0	−9	−3	−1
All other (net)				
Net total, other functions	$−0.5	−4	−17	3
Total, all functions	$43.3	5	−4	7

N/C = Not calculable.
Source: Senate Budget Committee.

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TAX FOUNDATION'S MONTHLY VOL. 27, NO. 3 APRIL 1983

TAX·FEATURES

Tax Freedom Day Falls on May 2; Taxes Take 2 Hrs.-40 Mins. of Workday

The average U.S. worker spends 2 hours and 40 minutes of each 8-hour workday earning money for Federal, state, and local taxes, Tax Foundation economists say. Federal taxes claim the lion's share—1 hour and 44 minutes—while state and local governments preempt 56 minutes' worth of daily earnings.

On the plus side, wage-earners in 1983 will have to devote one minute less of their day's worktime to earning tax money. The entire drop occurs on the Federal side of the tax ledger, according to Foundation analysts. They tally the Federal tax bite in an 8-hour day at 3 minutes less than it was in 1982, due largely to the impact of ERTA (the Economic Recovery Tax Act of 1981).

By contrast, states and localities will increase by 2 minutes their inroads into a worker's daily earnings. The Foundation reported recently that states put $4 billion in new taxes on the books in 1982 and are considering a record $12 billion worth of tax hikes for 1983.

Other large claims on the worker's 8-hour earnings include housing and household operations (1 hour, 34 minutes) and food and beverages (1 hour, 7 minutes).

The table below gives details on how much of the U.S. worker's 8-hour day in 1983 is devoted to earning enough money to meet major expenses. (See also box on page 4.)

Tax Bite in the 8-Hour Day 1983

Item	Hours and minutes
Tax, total	2 hours 40 minutes
Federal	1 hour 44 minutes
State and local	56 minutes
Housing and household operation	1 hour 34 minutes
Food and beverages	1 hour 7 minutes
Transportation	43 minutes
Medical care	35 minutes
Clothing	22 minutes
Recreation	21 minutes
All other[a]	38 minutes
TOTAL	8 hours

[a]Includes consumer expenditures for items such as personal business, and private education; and savings.
Source: Tax Foundation estimates as of April 8, 1983.

Tax Freedom Day will fall on May 2 this year, according to Tax Foundation economists. This is the second consecutive year in which the overall trend for this date to fall later in the calendar has been reversed, they report. This means that, as of May 2, the average worker would finish paying Federal, state, and local taxes if every cent earned from January 1 went to satisfy some level of tax obligation.

The contributing factors moving Tax Freedom Day earlier this year represent a mixed bag of good news and bad news, Foundation analysts say. On the plus side, ERTA, the Economic Recovery Tax Act of 1981, left more money in the pockets of American taxpayers. On the minus side, TEFRA, the Tax Equity and Fiscal Responsibility Act of 1982, imposed $98 billion in revenue hikes that prevented Tax Freedom Day from

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State Taxes

Tax Foundation, Incorporated

TAX FOUNDATION, INCORPORATED
1875 Connecticut Avenue, N.W., Washington, D.C. 20009

Moderate Earner Pays $6,323 in Taxes; Owes $2,269 More for Deficit Spending

Uncle Sam will spend $805.2 billion in fiscal year 1983. For a moderate-income family—one worker earning $25,000 solely from wages with a spouse and two dependent children—this will mean a tax bite of $6,323, according to Tax Foundation economists.

As spending edges gradually but inevitably toward the trillion-dollar mark, the place of the ordinary taxpayer in the scheme of things may be difficult to visualize. To clarify things, analysts at the Foundation choose the $25,000-a-year family and break down Federal spending in terms of its tax bill.

The most expensive item is labeled "income security." This includes social security and Federal employee retirement and disability, unemployment compensation, housing assistance, food and nutrition assistance, and other programs. The Federal budget lists $282.5 billion in total for these items. For the $25,000 earner described above, the cost is $2,163. That is, for each $1.00 he pays in taxes, Uncle Sam pays out 34 cents for income security to someone.

National defense costs $214.8 billion, or 26 cents out of each tax dollar. For the taxpayer described here, this amounts to $1,645. Interest on the public debt takes third place at $681 for this worker, almost 11 cents per dollar of taxes, followed closely by health expenditures, at $631, or almost 10 cents per dollar of taxes.

These four big programs account for more than 80 percent of all Federal spending. The remainder goes, in varying amounts, to the functions shown in the accompanying table.

The money to support these programs comes from tax dollars, nontax receipts, and government borrowing. Most of the tax money comes from the individual income tax. For this $25,000-a-year family, the income tax siphons off $2,445 from annual earnings. Social security taxes divert another $1,675 into Federal coffers.

Direct levies do not tell the whole story, though, according to Tax Foundation economists. A number of indirect taxes—employer's share of social security taxes, corporate income taxes, excise taxes on liquor, gasoline, tobacco, and air travel—claim another $2,203 of that paycheck.

Altogether, Federal taxes claim over 25 percent of this family's annual income. But that's not the whole story.

In addition to paying a big slice of current earnings for taxes, the family must assume a share of the $207.8 billion fiscal 1983 deficit. For the family described here, that burden is an additional $2,269. All told, current taxes and borrowing add up to over 34 percent of this moderate-income family's earnings.

How the Federal Government Will Spend A Worker's Tax Dollars in Fiscal 1983[a]

Function	Worker's share: Amount	Worker's share: Percent of total	Total amount (millions)
Income security	$2,163	34.21	$282,472
National defense	1,645	26.01	214,769
Interest	681	10.77	88,936
Health	631	9.98	82,362
Education, training, employment, and social services	204	3.23	26,676
Veterans' benefits	187	2.96	24,411
Transportation	168	2.65	21,876
Agriculture	161	2.55	21,075
Natural resources and environment	93	1.46	12,087
International affairs	91	1.45	11,939
General science, space, and technology	59	.94	7,759
Community and regional development	57	.89	7,373
General purpose fiscal assistance	49	.77	6,382
General government	44	.70	5,794
Administration of justice	40	.64	5,273
Energy	35	.55	4,506
Commerce and housing credit	15	.23	1,928
Total	$6,323	100.00	$805,202[b]

[a]In this example, the worker is the sole source of support for a spouse and two dependent children, and earns $25,000 per year.

[b]After deducting $20,414 million for undistributed offsetting receipts not classified by function.

Source: Office of Management and Budget, and Tax Foundation computations, based on official budget estimates presented January 31, 1983.

Now Available

Fiscal Policy Forum, "At Issue: The Balanced Budget Amendment," January, 6 pp.

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Odds and Ends—

U.S. Pensions in Bad Shape; Civil Service Errors Are Costly; Paying for D.C.'s Street Lights

Now that Congress and the Administration have straightened out the social security system, perhaps they can take on the Civil Service Retirement System. According to the Office of Personnel Management (OPM), escalating costs have placed the Federal system in worse shape than social security.

"Few Americans realize that the true debt of the Civil Service Retirement System (CSRS) now totals one-half trillion dollars ($500 billion)!" reports OPM Director Donald J. Devine. "On a per person basis, the unfunded liability of CSRS is much greater than that of the Social Security system."

Devine reports that, while outlays for social security were growing 1,209 percent between 1960 and 1981, Federal retirement spending jumped 1,891 percent. On top of that, Federal workers have increased their contributions to the system by only 427 percent, compared to a 2,351 percent hike in contributions by their employer, Uncle Sam. "Clearly, CSRS needs reform even more than does the Social Security system," Devine says.

Despite sharply rising contributions to the system, the unfunded liability of the CSRS has continued to grow. The problem stems from a combination of "overly-generous retirement benefits" and "inadequate employee contributions," according to the Reagan Administration. The 1984 budget recommends comprehensive reforms, including increases in employee contributions and other changes to restore the financial solvency of the fund and bring costs in line with those of private pension systems generally.

Civil Service Errors

To err may be human, as the Bard said. It can also be expensive.

Errors in the Federal government's classification system for civil service positions and pay are costing taxpayers nearly $682 million a year, according to a new study by the OPM. Based on a random audit of Federal white-collar jobs, the study reveals patterns of overgrading, undergrading, and occupational code and title errors among such workers. The results:

(Continued on page 4)

"The true debt of the Civil Service Retirement System now totals one-half trillion dollars."

THE FRONT BURNER

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"Why Can't We Cut Spending?"

Listen to these words of Thomas Jefferson:

I place economy among the first and most important virtues, and public debt as the greatest of dangers. To preserve our independence, we must not let our rulers load us with perpetual debt. We must make our choice between economy and liberty, or profusion and servitude. If we can prevent the Government from wasting the labors of the people under the pretense of caring for them, they will be happy.

Those words were the favorite Jeffersonian sentiment of Dallas L. Hostetler, the Florida businessman who first conceived the idea of Tax Freedom Day in 1948. As we celebrate Tax Freedom Day 1983—merely one day earlier than last year, despite all kinds of rhetoric about austerity budgets and spending restraints—I find myself wondering how we can prevent the government from doing us in under the pretense of caring for us.

I am by nature an optimistic man, a believer in positive thinking, and an advocate of constructive action. I am also growing a little impatient.

Candidates and officeholders come and go. The promises of something for nothing, of give-aways which will allegedly cost the recipient nothing, remain with us.

Jefferson foresaw this. He and the other framers of the Constitution knew that a representative form of government would tempt public officials to secure and increase their hold on power by using public funds to buy votes. That may be crassly put; it is, however, not inaccurate.

What the nation needs, as we lurch toward the 21st century weighed down by the shackles of a $1.3 trillion national debt and projected $200 billion 1983 deficit, is a national commitment to make this country solvent again.

We need to challenge the opinings of economists and legislators who tell us that there is nothing wrong, per se, with deficits. And we need to do so with solid, objective data. We need to unmask the euphemisms and weasel words. "Not subject to change under current law" means just that. If the legislators can muster the gumption, they can change the law. "Structural deficits" are, nonetheless, deficits. Spending cuts or tax increases can erase them. "Revenue enhancements" are merely the fox of tax increases dressed in the lamb's clothing of vague language. "Tax expenditures" is a philosophical slight of hand by which the government asserts ownership of everything we earn, except for that portion which it chooses to leave in our hands through tax deductions and exclusions. The "national debt" is merely living beyond our means today in the expectation that those who come after us will pick up the tab; it is mortgaging the future to live as spendthrifts in the present.

I like to think that Lincoln was right, that you can't fool "all of the people all of the time." Some day—and I hope it's soon—the sleeping giant that is the American worker and taxpayer will awaken to what is being done to him in the name of "public interest." I look forward to being around to watch the fireworks.

"What the nation needs... is a national commitment to make this country solvent again."

"Revenue enhancements are merely the fox of tax increases dressed in the lamb's clothing of vague language."

"Many states have legislated significantly higher taxes."

"Nearly 14.3 percent of the government's 1,312,000 full-time white-collar positions are overgraded."

Tax Bite in the 8-Hour Day
Selected Years, 1930-1983

Year	Hours and minutes: Total	Federal	State and local
1930	:57	:17	:40
1940	1:29	:45	:44
1950	2:02	1:30	:32
1960	2:22	1:40	:42
1970	2:34	1:40	:54
1975	2:35	1:38	:57
1980[a]	2:42	1:49	:53
1981[a]	2:47	1:54	:53
1982[a]	2:41	1:47	:54
1983[b]	2:40	1:44	:56

[a]Revised. [b]Forecast.

(TAX FREEDOM DAY, from page 1)

being even earlier. Also, many states have legislated significantly higher taxes.

Popularly described as the day the U.S. worker finishes paying taxes and starts working for himself, the idea was conceived by Dallas L. Hostetler, a Florida businessman, in 1948. He turned responsibility for the concept over to the Foundation upon his retirement in 1974. The table below shows selected dates for Tax Freedom Day since 1930.

Year	Tax Freedom Day
1930	February 14
1940	March 9
1950	April 4
1960	April 18
1970	April 28
1975	April 29
1980[a]	May 3
1981[a]	May 7
1982[a]	May 3
1983[b]	May 2

[a]Revised. [b]Forecast.

(U.S. PENSIONS, from page 3)

• Nearly 14.3 percent (188,000) of the government's 1,312,000 full-time white-collar positions are overgraded.

• About 1.5 percent (20,000) are undergraded.

• About 11.1 percent (146,000) have the wrong series. "If a position has the wrong series," the report explains, "it may be filled with an employee unable to do the work; that employee could be given the wrong training; and the employee might also be reassigned or promoted to another position the employee is unable to do."

• About 14.6 percent have the wrong title. This can also result in employees being placed in jobs for which they are not qualified, the report says.

On a more positive note, the OPM said that "the results of the study do not indicate that there have been overall changes in . . . the cost (constant dollars) of overgrading since our last report in 1978."

D.C.'s Light Bill

Budgetary balance has become a major headache for state and local officials during the economic downturn from which the nation is just beginning to emerge. Some officials have shown a good deal of ingenuity in avoiding red ink.

Mayor Marion Barry of Washington, D.C., has broken new ground in the area of fiscal creativity. His 1984 budget for the District will be balanced from the pockets of local utility customers, if the Mayor has his way. He proposes to shift the District's $12 million in street lighting costs to private customers of Potomac Electric Power Company (PEPCO), the local utility.

PEPCO has attacked the plan and is watching with jaundiced eye as the budget moves through the legislative pipeline. District officials support it as a way of avoiding spending reductions or tax hikes.

The D.C. City Council has let stand Barry's proposal and forwarded the 1983 fiscal plan to the U.S. House of Representatives. There the Subcommittee on the District of Columbia, chaired by Representative Julian C. Dixon (D-Ca.), will hold hearings, beginning on April 15.

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TAX·FEATURES

States Get Less in U.S. Grants And Pay Less in Taxes in FY82

Fiscal year 1982 marked the first time since World War II that Federal aid to the states and localities—and the associated taxes paid to support those aids—failed to rise. The cost of Federal grant programs in 1982 was $85.5 billion, down by $7.0 billion or 7.6 percent from 1981, and 3.5 percent below the 1980 level of $88.6 billion. This recent trend—stemming largely from the Omnibus Budget Reconciliation Act of 1981—stands in sharp contrast to the decade of the 1970s, when Federal grants to state and local governments grew at an average annual rate of 15 percent.

Twenty states paid more in tax dollars to support Federal grant programs than was received by their state and local governments in fiscal year 1982, according to Tax Foundation economists.

For the second year in a row, the residents of the Lone Star State paid the highest tax "premium" for grants. Each Federal aid dollar coming to Texas cost the state's residents $1.59. The other top "paying" states were Connecticut ($1.40), Florida ($1.30), Kansas ($1.29), and Colorado ($1.29).

At the other end of the scale, Vermont residents paid 57 cents in Federal tax dollars in support of the grant programs for each dollar of aid received by their state and local governments. Favorable balances were also experienced by Mississippi (57 cents), Maine (60 cents), Alaska (61 cents), South Dakota (62 cents), and New Mexico (69 cents).

As a whole, the residents of the "paying" states remitted $47.7 billion in Federal taxes to support grant programs, while their state and local governments received $39.1 billion in Federal grants—an average of $1.22 per aid dollar. The residents of the "receiving" states, on the other hand, paid $37.8 billion in Federal taxes for the nearly $46.4 billion received in Federal grants, or 81 cents in taxes for each $1.00 of aid received.

Compared to fiscal year 1981, the costs of Federal aid received rose in 22 states, fell in 24 states and the District of Columbia, and remained the same in four states (Arkansas, Iowa, New Mexico, and Wyoming). The largest increase was in Texas, where Federal tax burdens per $1.00 of grants received rose by 13 cents—from $1.46 to $1.59. In Tennessee and North Dakota, Federal tax burdens per dollar of aid received rose by 10 cents—from 82 cents to 92 cents, and from 73 cents to 83 cents, respectively.

The largest decline in tax costs per dollar of aid was "enjoyed" by the residents of New Hampshire—from $1.21 in 1981 (when it ranked 8th) to $1.08 in 1982 (when it ranked 18th). Oregon rejoined the ranks of the "receiving" states as its Federal tax burden per dollar of aid fell from $1.08 in 1981 to 97 cents in 1982 (Maryland's ratio fell from $1.03 to 98 cents). The ratio

(Continued on page 2)

Tax Index Rises in 1982; Marks 24 Consecutive Years Of Increases in Tax Load

Recent Federal tax cuts and the economic recession notwithstanding, the Tax Foundation's overall Tax Index moved upward in calendar year 1982. The Index, which measures trends in Federal, state, and local taxes based on 1967 as 100, reached 413.9 in 1982, edging up a

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Foreign source income

Tax Index and Related Measures

Annually, and Quarterly at Seasonally Adjusted Annual Rates, 1967 = 100
Selected Periods, 1970 to 1982

Calendar year and quarter	Tax Index			Output Index[a]		
	Total	Federal	State and local	Current prices	Constant prices	Price Index[b]
Annually						
1970	132.2	127.5	142.1	124.2	107.3	115.7
1975	204.3	191.0	232.1	193.8	122.0	158.8
1976	234.0	220.7	261.7	214.9	128.4	167.4
1977	263.1	249.7	291.1	239.9	135.4	177.1
1978	296.2	287.3	314.8	270.6	142.2	190.3
1979	331.5	328.4	338.0	302.4	146.3	206.7
1980	361.2	358.9	365.8	329.3	145.7	226.0
1981	412.4	416.9	403.2	367.4	148.6	247.3
1982	413.9	406.3	429.8	382.6	146.0	262.0
Quarterly						
1980 I	351.7	349.4	356.4	322.2	147.8	217.9
II	348.7	345.5	355.4	321.8	144.1	223.3
III	363.2	360.1	369.7	330.6	144.7	228.4
IV	381.0	380.6	382.0	342.6	146.3	234.2
1981 I	405.4	411.4	392.8	358.3	149.1	240.3
II	410.3	416.2	398.0	362.9	148.5	244.3
III	419.8	425.0	409.1	372.8	149.3	249.6
IV	414.3	414.9	412.9	375.6	147.3	254.9
1982 I	407.6	404.4	415.1	374.6	145.4	257.6
II	413.8	408.5	424.7	380.8	146.2	260.5
III	415.8	406.1	436.0	386.2	146.4	263.7
IV	418.6	406.7	443.5	388.7	146.1	266.2

[a]Gross national product.
[b]Implicit price deflator for gross national product.
Source: Tax Foundation computations and estimates based on data from U.S. Department of Commerce, Bureau of Economic Analysis.

Federal Grants-In-Aid to State and Local Governments and Estimated Federal Tax Burden for Federal Grants
Fiscal Year 1982

State	Millions		Tax burden per dollar of aid	
	Grants[a]	Estimated tax burden for grants[b]	Amount	Rank
TOTAL	$85,494.2	$85,494.2	$1.00	—
Alabama	1,394.0	1,085.1	.78	37
Alaska	391.7	240.3	.61	47
Arizona	779.5	946.1	1.21	8
Arkansas	816.9	592.0	.72	44
California	8,931.9	10,119.1	1.13	14
Colorado	920.0	1,183.5	1.29	5
Connecticut	1,120.1	1,566.2	1.40	2
Delaware	279.4	244.9	.88	29
Florida	2,855.7	3,705.5	1.30	3
Georgia	2,181.5	1,691.2	.78	38
Hawaii	407.6	371.4	.91	28
Idaho	329.5	275.3	.84	32
Illinois	4,101.6	4,978.0	1.21	9
Indiana	1,557.9	1,915.5	1.23	7
Iowa	892.8	1,052.9	1.18	11
Kansas	704.8	910.6	1.29	4
Kentucky	1,412.5	1,035.9	.73	43
Louisiana	1,588.4	1,475.7	.93	26
Maine	526.7	317.5	.60	48
Maryland	1,820.7	1,785.5	.98	21
Massachusetts	2,745.2	2,283.8	.83	33
Michigan	3,631.8	3,438.8	.95	23
Minnesota	1,767.2	1,539.9	.87	30
Mississippi	1,072.0	606.5	.57	49
Missouri	1,647.9	1,683.1	1.02	20
Montana	349.9	265.5	.76	39
Nebraska	523.1	562.7	1.08	19
Nevada	328.4	364.8	1.11	15
New Hampshire	316.4	342.5	1.08	18
New Jersey	2,718.4	3,418.4	1.26	6
New Mexico	563.4	387.1	.69	45
New York	9,287.5	6,995.2	.75	40
North Carolina	1,849.8	1,738.3	.94	25
North Dakota	285.6	236.8	.83	34
Ohio	3,611.0	3,977.3	1.10	17
Oklahoma	986.1	1,094.8	1.11	16
Oregon	969.9	939.6	.97	22
Pennsylvania	4,626.9	4,356.7	.94	24
Rhode Island	471.0	351.7	.75	41
South Carolina	1,039.4	850.8	.82	36
South Dakota	321.4	199.9	.62	46
Tennessee	1,502.5	1,382.9	.92	27
Texas	3,719.8	5,900.2	1.59	1
Utah	520.0	428.4	.82	35
Vermont	270.4	152.8	.57	50
Virginia	1,644.6	1,995.5	1.21	10
Washington	1,548.8	1,794.4	1.16	12
West Virginia	770.5	568.1	.74	42
Wisconsin	1,893.3	1,618.8	.85	31
Wyoming	190.0	219.9	1.16	13
District of Columbia	1,308.9	307.0	.23	51

[a]Excludes shared revenues and payments in lieu of taxes; includes general revenue sharing and trust fund aids
[b]The total tax burden for grants is assumed to equal grant payments.
Source: Tax Foundation computations based on data from U.S. Treasury Department and Office of Management and Budget.

Monthly Tax Features

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(TAX INDEX, from page 1)

fraction of a percent from its 1981 level of 412.4. According to Tax Foundation economists, 1982 marked the 24th consecutive rise for the annual Tax Index.

While the overall trend was up, the various components underwent a mixture of ups and downs. The Federal Tax Index dropped from 416.9 to 406.3 (2.5 percent), reflecting a sharp decline in accruals of corporate profits taxes (corporate profits dropped by nearly 20 percent) and the crude oil windfall profits tax, and a smaller rise in personal income taxes than would have occurred without the tax cuts of ERTA, the Economic Recovery Tax Act of 1981. Boosts in social insurance taxes were the major component preventing the Federal Index from declining even more.

Unlike its Federal counterpart, the State-Local Tax Index continued its long-time upward movement, rising 6.6 percent from 403.2 in 1981 to 429.8 in 1982 (1967=100). The strongest element in the rise was the local property tax, for which collections in 1982 were nearly 14 percent ($10.5 billion) higher than in 1981. State personal income and sales taxes exhibited modest increases—bolstered in part by legislative tax increases—while corporate profits taxes were off by more than 25 percent, an even larger drop than their performance at the Federal level.

Calendar year 1982 marked the first time since 1975 that the annual Federal Tax Index had declined from the previous year. State-local taxes have not shown an annual reduction since 1933.

The rise in the Tax Index in 1982 failed to match the 4.1 percent increase in the nation's current dollar output or the 6 percent hike in the price index. The standing of the Tax Index relative to its 1967 base, however,

(Continued on page 4)

MARK YOUR CALENDAR

Tax Foundation's 35th National Conference and 46th Annual Dinner will be held this year on Wednesday, November 30, 1983, at the Plaza Hotel in New York City. Details will follow in future issues of *Monthly Tax Features*.

(GRANTS-IN-AID, from page 1)

declined by 10 cents in Missouri and South Carolina.

The direct cost, in terms of Federal tax burdens per dollar of aid received, does not tell the entire story. Most Federal grant programs require matching funds, and the Office of Management and Budget estimates that for each $1.00 of aid from Washington, state and local governments must ante up another 45 cents. And this figure does not include any administrative or overhead costs that the recipient governments must bear.

The Tax Foundation formula for deriving the Federal tax burdens by state is designed to show where the tax dollars actually originate, rather than where they are collected. The grant-in-aid data are shown as reported by the U.S. Treasury.

The accompanying table provides further details. Single copies of the complete "Memorandum on the Allocation of the Federal Tax Burden and Federal Grants-in-Aid by State, Fiscal Year 1982" are available free from the Tax Foundation (plus $1.00 postage and handling).

Tax on Health Premiums Poses Questions

The Reagan Administration proposes in its fiscal year 1984 Budget that employees be required to pay social security and income taxes on employer-paid health insurance premiums above certain amounts. Legislation has been introduced in the Senate (S.640) by Senator Robert Dole (R-Kan.) and in the House (HR.2574) by Representative Barber Conable (R-N.Y.) which would impose a maximum level above which employer contributions would no longer remain tax free.

The most commonly cited justifications set forth for such a ceiling is that the "tax benefit" makes health insurance coverage less expensive than if the employees were given an equivalent amount of cash and told to purchase their own health insurance. Employees would purchase less insurance (higher deductibles, fees for specific service, narrower coverage, etc.), the argument runs, and would also make less use of health care facilities and services. This, it is suggested, will help slow the rapid rise in health care costs.

The link between the level of health insurance coverage of American workers and the increasing cost of health care services raises a number of questions. Can the fixed costs of hospitals, equipment, training of personnel, and research and development of medicines be significantly affected by reducing the insurance coverage of U.S. workers? Does the gain that may accompany reduced coverage and reduced use of health services outweigh the potential loss in preventive care? Does the demand for health care services by the non-covered workers, the unemployed, the retired and elderly, have a stronger impact on health care costs than health-related fringe benefits?

A major source of the demand for health care services, of course, is the Federal government itself. During fiscal year 1982, Uncle Sam spent $74.0 billion on health-related programs, more than 90 percent of which was spent directly on health care services. Current projections estimate that spending will increase to $94.7

(Continued on page 4)

"A major source of the demand for health care services is the Federal government itself."

THE FRONT BURNER

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"About-Face on Withholding"

Few reversals in Washington have been as rapid as the reversal on implementing the provision to withhold taxes from income earned on interest and dividends. The reversal came despite tremendous support for withholding from the leadership in both Houses of Congress, as well as from the White House.

Why?

One reason, of course, is that the U.S. Congress begins to see the light when it starts to feel the heat. However, to give all the credit to the bankers for generating that heat is simplistic in the extreme.

No interest group in our pluralistic society can hope to wield enough clout to force Congress to reverse on a major issue. To assert otherwise is to impugn the integrity of the highest legislative body we have.

The banks may have publicized the problem, as is their right. But hundreds of thousands of savers and investors told the decision makers in Washington how they felt about the withholding provision.

What stuck in most people's craws stems from a misreading by the lawmakers of two important points:

• First, the withholding debate portrayed the average taxpayer and saver as a scofflaw, a tax cheat. The tax-writers had in mind a revenue grab—an estimated, some would say an overestimated, $17.8 billion. They sought to finesse their greed by branding the ordinary saver and investor as dishonest. It didn't fly.

• Second, opponents of the bill did not get their day in court. The provision originated in the Senate Finance Committee and was rammed through the Committee with virtually no debate and in a one-sided party line vote that flew in the face of a long-standing tradition of bipartisan tax policy on the Committee. Those fighting for their day in court were threatened with even more stringent tax legislation if they opposed and defeated the withholding provision.

Such a cavalier attitude generated deep resentment. In our representative democracy we are used to arguing strongly for a position, taking a vote, and accepting the decision and working to make it succeed. "You win some, and you lose some" is a fundamental axiom of the political process.

The trouble with the withholding legislation, as passed last year, was that most of the nation wasn't even allowed in the ballgame. That proved intolerable to the American public, which has now made its feelings known.

"The trouble with the withholding legislation, as passed last year, was that most of the nation wasn't even allowed in the ballgame."

Tax Foundation, Incorporated

"Social insurance levies have attained by far the highest Index standing relative to the 1967 base."

(TAX INDEX, from page 2)

remains significantly above the output and price indexes, as shown in the table on page 1.

The table also presents the Tax Index and related measures on a quarterly basis since 1980. In the latest quarter reported—October-December, 1982—the Tax Index moved up at an annual rate of 2.8 percent from the previous quarter, as a 7 percent annual rise in the State-Local Index was accompanied by a negligible (.4 percent) increase in the Federal Index.

During the economic downturn that began in July 1981, the Tax Index followed the general cyclical contraction in the fourth quarter 1981 and the first quarter of 1982, but rose slightly in the last three quarters of 1982, again reflecting relative strength in state-local taxes counterbalancing weaknesses in Federal tax accruals. The quarterly reductions in the Tax Index that did take place were all accounted for by Federal taxes. The State-Local Tax Index continued to rise throughout the latest recession, which may have ended last December.

By type of tax, social insurance levies have attained by far the highest Index standing relative to the 1967 base. Personal income taxes came in a distant second. The major components of the Tax Index (Federal and State-Local combined) for the fourth quarter of 1982 (1967=100) were as follows:

Tax	Index
Social insurance	596.4
Personal income	490.2
Indirect business (sales, property, excises)	365.5
Miscellaneous	235.8
Corporate profits	178.9

The Tax Index is a fiscal yardstick designed by Tax Foundation economists to provide a continuing measure of trends in taxes, on a basis comparable to official indexes for other segments of the economy.

Now Available

"Consumption Tax: An Idea Whose Time Is Coming," *Special Report*, April, 28 pp., $5.00.

"The Federal Fiscal Dilemma: Is There a Solution?", *Proceedings* of Tax Foundation's 34th National Tax Conference, 1982, 36 pp., $7.50.

"Unemployment Insurance: Trends and Issues," *Research Publication* No. 35, 96 pp., $5.00.

(Please include $1.00 for postage and handling on all orders.)

Effect of Limiting Exclusions for Employer Contributions to Health Care Plans to $150 Per Month for Family Subscribers and to $60 Per Month for Individual Subscribers

Income level ($000)	Subscribers affected by limit: Family coverage Number (000)	Family coverage Percent of total covered	Individual coverage Number (000)	Individual coverage Percent of total covered	Average increase in total tax[a]
0-10	426	25.5	512	17.3	$ 86
10-15	510	18.6	855	21.5	118
15-20	1,255	27.0	1,051	26.6	135
20-30	3,163	26.8	2,110	26.2	163
30-50	6,098	36.5	3,237	28.6	235
50 +	2,492	34.4	1,769	16.6	245

[a]Excludes subscribers whose tax liability does not change, excludes employers' share of social security tax, and any increased state tax liability.

Source: "Tax Expenditures and the Demand for Private Health Insurance," 1982, U.S. Department of Health and Human Services, and Tax Foundation computations.

(HEALTH INSURANCE, from page 3)

billion by fiscal year 1985. In comparison, the estimate of the total Federal individual income tax revenue forgone by the exclusion of employer contributions from employee income is $16.5 billion for fiscal year 1982.

Limiting the exclusion would increase individual tax bills by $2.4 billion if caps of $175 per month family coverage and $75 per month individual coverage were adopted and by $3.9 billion for caps of $150 per month family coverage, $60 per month individual coverage. Under the latter plan, 34 percent of all subscribers covered by employer-provided health insurance would be affected, with an average tax increase of $198.

The accompanying table sets out the distribution of subscribers by income class affected by a $150/$60 cap and the average increase in tax they would pay.

Toward better government Founded 1937

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U.S. Tax Treatment of Foreign Source Income

By Douglas N. Beck
Staff Economist

Recently there has been increasing talk of modifying the various provisions contained in the U.S. Tax Code pertaining to the treatment of domestic corporations involved in international trade. Motivated by numerous, often conflicting goals, several proposals have been made that would either curtail or eliminate the foreign tax credit, "deferral," and the law establishing Domestic International Sales Corporations (DISC)—the three provisions that form the basis of U.S. tax policy relating to international trade. The foreign tax credit and deferral, which have been part of the Tax Code since 1918, serve to neutralize tax considerations in worldwide investment decisions. On the other hand, DISC, enacted only twelve years ago, was designed to encourage exports of U.S. products. Although the basic nature of the foreign tax credit and deferral are dissimilar to DISC, they will be considered together for ease of presentation.

The renewed movement to alter these provisions is largely a response to two conditions currently plaguing the American economy. First is the prospect of big budget deficits continuing for many years and the consequent search for new sources of income to narrow this gap. Opponents of the provisions see them as "loopholes" that can be closed to raise large sums of additional revenue.

Second is the claim that current U.S. tax law, in particular the foreign tax credit and deferral, is in part responsible for the high level of unemployment that plagues the American economy. Critics claim that these provisions permit more favorable tax treatment for foreign source income than for income earned domestically and thereby provide an incentive for U.S. businesses to invest in foreign countries rather than in the United States. This "substitution" of foreign for domestic investment causes jobs to be "exported" overseas. Tightening the tax treatment of U.S. firms investing abroad would reduce foreign operations and increase domestic investment, thereby increasing U.S. employment.

Another important consideration is the claim by several European countries that DISC violates the General Agreement on Tariffs and Trade (GATT), ratified in 1947 to establish an international code on tariffs and trade rules. GATT's goal was to reduce impediments to international trade created by high tariffs, import quotas, and other discriminatory trade practices. This agreement is widely believed to have been responsible for the dramatic increase in world trade over the last forty years and the accompanying rise in the standard of living in signatory countries.

U.S. TAX LAW

Tax law in the United States recognizes the importance of the principle of international tax neutrality, also known as capital export neutrality, which holds that the tax laws of a given country should neither favor nor discourage foreign over domestic investment. In practice, neutrality requires that the overall level of taxation on foreign source income of a firm or individual be the same as for domestic source income. Investment decisions can thus be made based on economic variables rather than tax considerations, promoting international specialization in production with a resultant increase in worldwide income. Deviations from tax neutrality can create distortions causing resources to be misallocated and income reduced.

FOREIGN TAX CREDIT

Under U.S. law, American citizens are taxed on their worldwide income. In order to prevent the double taxation of income earned abroad, a dollar-for-dollar credit is allowed for taxes paid by U.S. citizens to foreign governments. This credit mechanism also concedes to the host government the initial share of taxation on income generated within its borders.

To see how the foreign tax credit works, suppose an American firm earns $100,000 within a foreign country that imposes a 20 percent income tax. The U.S. tax liability on this income is $46,000 based on a statutory corporate income tax rate of 46 percent. Against this amount the taxpayer is allowed a credit of $20,000 for taxes paid to the host country. The remaining $26,000 is paid to the U.S. Treasury. If the tax rate imposed by the host country was equal to or greater than 46 percent, the U.S. tax liability on that foreign source income is zero.

U.S. law also allows a credit for foreign taxes paid through foreign corporations, provided that the U.S. corporation owns at least 10 percent of the voting stock of the foreign corporation. This "deem paid" credit provision allows the U.S. corporations to claim a credit for foreign taxes paid on the earnings of a foreign subsidiary out of which dividends are paid to the U.S. corporation. For example, suppose that a domestic corporation receives a dividend of $80 from a foreign corporation. This $80 dividend represents $100 in income earned by the foreign corporation from which $20 in taxes is paid to the host government. For purposes of calculating the U.S. tax liability, the $20 in foreign taxes paid is added to the $80 dividend, making the taxable foreign source income of the domestic corporation equal to $100. This is known as "grossing-up" the dividend. The U.S. tax liability is $46 ($100 x 46%) against which a credit of $20 is granted, and the balance of $26 is collected by the U.S. Treasury.

In actual practice the foreign tax credit becomes somewhat more complicated. In order to be creditable, a foreign tax must be of the predominant character of the U.S. income tax.

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In particular, the foreign tax must not be a payment in return for a specific economic benefit. It must be based on the taxpayer's realized net income, and it must be subject to the reasonable rules of the taxing jurisdiction. These limitations prevent payments to foreign governments for goods and services received, which are really a business expense, from being used to reduce U.S. tax liability; they also prevent foreign governments from enacting so-called "soak-up" taxes, levied by the host governments exclusively on U.S. firms to collect the difference between the tax rates of the foreign country and the United States. By limiting the creditability of taxes to those that the host country imposes on its own domestic firms, this abuse is prevented.

A second source of complexity results from the limitation that U.S. law places on how much credit may be claimed for foreign taxes paid. This limit prevents credits in excess of those necessary to offset U.S. tax liability on foreign income from being used to reduce tax liability on domestic source income. The credit limitation is computed by multiplying the ratio of a company's foreign source taxable income to its worldwide taxable income by its pre-credit tax liability. The amount of tax that may be credited is limited to the amount of tax that would have been imposed had the income been earned domestically. For example, if a U.S. corporation earns $1,000,000 from foreign sources, the credit for foreign taxes paid is limited to $460,000, which would be the U.S. tax liability on this income if earned domestically. If the host government imposes a 60 percent income tax, the company will be able to credit only $460,000 of the $600,000 it would owe the foreign government. The remaining $140,000 would have to be absorbed out of profits.

For foreign tax credits in excess of this limitation, a carryback/carryforward provision is allowed. Credits that cannot be used in the current year may be carried back to the two preceding taxable years or forward to the five succeeding taxable years. While providing for partial recovery of credits that would otherwise be lost, this rule does not totally offset the restrictive effect of the foreign tax credit limitation.

Although credit limitation prevents excess credits for foreign taxes from reducing U.S. tax liability on domestic source income, nevertheless U.S. liability may be reduced when foreign losses exceed foreign income. In these cases the amount of the net operating loss may be deducted from domestic taxable income. In order to limit the benefits of this provision, such losses are subject to recapture. A portion of foreign source income earned in subsequent years is treated as if it were earned from domestic sources. Such treatment is limited to the amount of the loss or 50 percent of the foreign source income for the subsequent year, whichever is less, although the taxpayer may have a larger percentage recharacterized as domestic income if he chooses.

The U.S. Tax Code requires that domestic companies apply the foreign tax credit separately to their foreign oil and gas activities. These companies must first compute a credit limit for all their oil- and gas-related income, and then a separate limit for their extraction income. The amount of foreign tax credits that may be claimed on this income is limited to the lesser of the overall oil-related limit, or extraction income limit plus taxes paid on non-extraction, oil-related income. Prior to the enactment of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), extraction losses in one country were not included when calculating overall extraction income. Presently, losses incurred in one country offset income earned in another, limiting the amount of the foreign tax credit that may be claimed. Extraction taxes in excess of this limitation for the current year may be carried back two years or forward five years provided the amount does not exceed 2 percent of the taxpayer's extraction income.

DEFERRAL

Companies incorporated under the laws of the United States are subject to U.S. taxation on their worldwide income, including income earned by foreign branch operations. Yet, in most instances, domestic corporations conduct their foreign operations through a subsidiary corporation rather than a branch operation. Many factors, including the laws of the host country, frequently necessitate this form of organization.

Because a foreign subsidiary is a separate legal entity, its income is not included in the worldwide income of its domestic parent company or subject to taxes under the U.S. law until it is actually received by the parent in the form of a dividend. When dividend income is received, a credit is allowed to the parent for taxes paid by the subsidiary to the host government on earnings out of which the dividend is paid. The amount of the credit is determined using the gross-up method in the same way as the deem paid credit.

The tax significance depends on the difference between the rate imposed by the host country and that imposed by the United States. In cases where the host country imposes a tax rate that is either equal to or greater than the U.S. rate, there will be no U.S. tax liability and the timing advantage associated with deferral will have no effect. This is the case in most industrialized nations. Only in cases where the host country imposes a considerably lower income tax rate than the United States will the impact of deferral be significant. This occurs most often in developing countries that utilize their tax structures as a means of encouraging investment and growth. Such countries will occasionally defer collection of their taxes as a further incentive. If an acceleration of tax payments is imposed, U.S. subsidiaries operating in certain foreign countries could be faced with significantly higher taxes.

DOMESTIC INTERNATIONAL SALES CORPORATION (DISC)

The third major aspect of U.S. law affecting U.S. businesses involved in foreign trade is DISC. This legislation, enacted under Title V of the Revenue Act of 1971, is designed to encourage exports of U.S. products by granting favorable tax treatment for income earned from export sales by the DISC. Basically, the DISC functions by buying domestically produced products and reselling them abroad.

In order for a corporation to qualify as a DISC, at least 95 percent of its gross receipts must come from qualified exports, and 95 percent of its assets must be qualified export assets. An additional requirement is that the corporation must have only one class of stock, and it must maintain capital of at least $2,500 at all times.

If these conditions are met, the corporation is entitled to special tax treatment consisting of deferral of taxation on a portion of its income equal to one-half of the excess over a prescribed base amount. This base amount is defined in the

law to be 67 percent of the average gross export receipts for the four-year period commencing with the seventh year prior to the tax year in question. For example, the base period for the taxable year beginning in 1982 would be 1975 through 1978. The balance of the DISC's income is taxed currently to its shareholders as a deemed distribution even if not actually distributed. To see how this provision works, suppose that a DISC had qualified export receipts of $1,000 in a current tax year and average gross receipts of $500 in its base period. According to the incremental rules, the base amount would be $335 (67% × $500), and the amount of income upon which taxation is deferred would be $332.5 (½ × [$1,000 − $335]). The remaining $667.5 would be taxed concurrently to the shareholders.

Incremental rules added to the original DISC legislation by the Tax Reform Act of 1976 significantly modified the original act. The change was designed to limit DISC benefits to new incremental exports, and thus to make the program more cost effective and more efficient at achieving its original goal of increasing exports. Under the original law, a postponement was granted for taxation on one-half of total DISC income with the other half taxed to the shareholders as a deemed distribution. It was felt that this resulted in an unintended benefit for exports that were based on contracts entered into prior to DISC.

Pricing Under DISC

In practice, the DISC is usually established as a subsidiary of domestic corporations and is frequently only a paper corporation sharing employees and offices with the parent corporation. The only separation legally required between the DISC and its parent is that the DISC maintain its own books and records. This set-up raises the issue of the allocation of income between the parent and the DISC and the related issue of inter-company pricing.

In most circumstances, the pricing of sales between parent and subsidiary corporations is governed by a set of very explicit rules and regulations established by the Treasury Department under the authority granted by Section 482 of the Tax Code. These rules are based on the "arms-length" principle, which requires that prices charged between a parent corporation and its subsidiary be the same as those charged between unrelated parties. This rule is meant to insure that inter-company prices reflect economic realities and are not used as a means of shifting income between related parties to avoid taxes.

These rules and regulations do not apply to prices charged between a DISC and its parent. Under the law a DISC is permitted to charge a price that allows it to realize a taxable income which does not exceed the greater of the following:

(1) 4 percent of the qualified export receipts derived from the resale of the property of the DISC, plus 10 percent of the "export promotion expenses" of the DISC allocable to these receipts (known as the four-percent method);

(2) 50 percent of the combined taxable income derived by both the seller and the DISC from the sale and resale of the property that is attributable to the qualified export receipts, plus 10 percent of the export promotion expenses of the DISC allocable to these receipts (known as the 50-50 method); and

(3) the actual taxable income computed under Section 482 (the "arms-length" method).

CONCLUSION

FTC and Deferral

Opponents of the foreign tax credit and deferral claim that these provisions constitute an unfair incentive for domestic firms to move their operations abroad, resulting in jobs being exported. These critics advocate replacing the foreign tax credit with a deduction, claiming that taxes paid to a foreign government are of the same nature as any other business expense and, therefore, should be deducted from taxable income rather than credited against taxes due. Furthermore, they claim that this would bring the treatment of foreign taxes into line with state taxes, which are deductible rather than creditable.

Critics of the deferral provision claim that it, like the foreign tax credit, provides an incentive for domestic companies to move their operations abroad. They argue that, since the deferral provision allows a domestic corporation to postpone the payment of taxes on income until that income is actually received by the parent, the domestic corporation pays a lower effective tax rate on foreign source income than on domestic source income. Furthermore, in the case where retained earnings are never repatriated, taxes may never be collected.

Proponents of this view advocate the acceleration of taxation on foreign source income. This would be accomplished in one of two ways: limiting the amount of income on which taxation could be deferred, by treating a certain percentage of this income as a deemed distribution to the domestic parent even if no distribution actually takes place; or limiting the length of time for which taxation could be deferred.

The purpose of the foreign tax credit is to prevent international double taxation of foreign source income, and to allow investment decisions to be made independently of tax considerations. The effect of replacing the foreign tax credit with a deduction would be to increase the level of taxation on foreign source income, reducing the ability of U.S. firms to compete in foreign markets. To see the effect of this change, suppose that a U.S. corporation had $100,000 of foreign source income on which it paid $40,000 in taxes to the host government. With the credit, the company would pay $6,000 in taxes to the U.S. government, yielding a total tax liability of $46,000, or 46 percent. If the credit were replaced with a deduction, the tax liability of the company would increase dramatically. The $40,000 of taxes paid to the foreign government would be deducted from the gross income of the company, making its taxable income equal to $60,000. The U.S. tax liability on this amount would be $27,600 (46% × $60,000), making the overall tax liability on the $100,000 of foreign source income equal to $67,600 or 67.6 percent. This increased level of taxes could severely limit foreign investment by U.S. firms.

The belief that this change would increase domestic investment and employment, which gives the proposals such popular appeal, is based on questionable premises. First is the notion that U.S. firms establish operations abroad solely for the purpose of tax avoidance. The FTC does not result in a lower overall level of taxation on foreign source income. Rather, it insures that competing tax claims do not result in double taxation of this income. Of far more importance than tax considerations in decisions to invest abroad is the need

to be able to remain competitive in international markets. The second erroneous belief is that foreign investment substitutes for domestic investment. This view results from the tendency to view overall investment as being fixed in amount and, therefore, to regard investments made abroad as substitutes for investments that would be made domestically. In the real world, the amount of investment is determined by the availability of profitable investment opportunities. Consequently, there is no logical reason to believe that any foreign investment that might be discouraged by increasing the taxation of foreign source income would automatically be translated into domestic investment.

Another flaw in proposals to change foreign source income taxation is that many of them overstate the amount of revenue that would result from such changes. Revenue projections are typically based on the assumption that U.S. corporations with foreign operations would not modify their behavior in the wake of a change in their tax treatment. Such a response would seem very unlikely. If deferral were to be eliminated, foreign subsidiaries would be more likely to accelerate distribution of their earnings in order to minimize their overall tax burden by crediting foreign withholding taxes imposed by host governments on dividends paid outside their country against current U.S. tax liability. The effect would be much lower revenue gains for the U.S. Treasury than projected.

A related concern is the reaction of foreign governments to these changes in the U.S. Tax Code. Such changes are unlikely to be popular with other governments because they impose the U.S. tax structure on other countries, violating their sovereignty to determine the effective tax policy within their borders. It seems quite likely that foreign governments would respond by imposing new taxes or engaging in other discriminatory practices against U.S. firms.

Such proposals would also place a much greater tax burden on foreign source income and make it much more difficult for U.S. firms to conduct business abroad and to compete in international markets. Ultimately, the only beneficiaries of these proposed changes would be foreign corporations which would be able to claim the share of the world's markets previously held by U.S. firms. The issue has been incorrectly presented to the public as being over whether U.S. firms will invest domestically or abroad. The real issue is whether the United States is going to share in the benefits of increased international trade. If U.S. corporations are not allowed to take advantage of profitable investment opportunities in foreign countries, corporations from other countries will, and the U.S. economy will be denied the benefits of those investments. In the long run, such policies could seriously jeopardize the health of the American economy.

The overriding attention that has been given to the effect of foreign investment on domestic employment has obscured the numerous benefits of foreign investment, one of which is the inflow of revenues received by U.S. firms as returns on these investments. These revenues increase the supply of funds available for domestic investment and thereby supplement domestic investment rather than substitute for it.

DISC -Current Proposals for Revision

The critics of DISC are primarily foreign governments claiming that the provision is in violation of GATT. Recent proposals aimed at making the DISC provision conform with GATT requirements while maintaining its export incentive and remaining revenue neutral fall into two categories.

The first, as proposed by Rep. Guy Vander Jagt (R-Mich.), would place an interest charge of 4 percent on DISC deferred income for small exporters (those with less than $250,000 of DISC taxable income) and an interest charge equal to the Federal funds rate for large exporters. The incremental rules would be replaced by a rule allowing for deferral of 100 percent of DISC taxable income up to $250,000 and for 45 percent of DISC taxable income in excess of this amount. All DISC income existing for taxable years prior to December 31, 1983, would be deferred permanently.

The second type of proposal involves establishing foreign corporations through which export sales would be made. One plan, introduced by Rep. Bill Frenzel (R-Minn.), calls for the establishment of an International Sales and Service Corporation (ISSC). The requirements to qualify and the pricing rules applicable would be basically the same as under the present DISC legislation. For tax purposes, the ISSC would be deemed to distribute 60 percent of its taxable income, which would be taxed to the shareholder as a dividend. The remaining 40 percent would be considered tax-free provided that it is invested for one year in qualified trading assets before it is distributed as a dividend.

Another proposal, introduced by Sen. David Boren (D-Okla.), calls for the establishment of an Export Sales Corporation (ESC) in a foreign country through which export sales would be made. The tax treatment of such a corporation would consist of a 100 percent deemed distribution of income. The shareholders would be granted a 26 percent dividend received deduction. The effect of this would be to reduce taxation on export income by 26 percent.

The Reagan Administration has also proposed replacing DISC with a foreign corporation through which export sales would be made. This proposal would permit the foreign corporation to use inter-company prices that generate taxable income that is equal to the greater of:

(1) 17 percent of the combined taxable income earned by the foreign corporation and its related U.S. manufacturer; or

(2) 1.35 percent of the foreign corporation's gross sales, up to 34 percent of the combined taxable income; or

(3) the income it would earn using the arm's-length rules prescribed under Section 482.

Continued pressure from foreign governments makes the enactment of one of these proposals very probable.

Perhaps the most important consideration when discussing international trade and U.S. participation therein is its implications for international economic growth and development. Stability in international affairs is inseparably related to increased international trade. Freer international trade promotes global peace and stability through increasing worldwide output and by fostering international cooperation.

The continued health and prosperity of the U.S. economy, as well as that of the worldwide economy, are linked to continued U.S. participation in international trade. This, in turn, depends on tax policy at least as favorable as the present provisions of U.S. tax law.

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TAX FOUNDATION'S MONTHLY VOL. 27 NO. 5 JUNE 1983

TAX·FEATURES

Spending Power Drops $1,333 In Wake of Decade's Taxes, Inflation

The prototypical U.S. family is $1,333 poorer than it was ten years ago, according to new analysis by Tax Foundation economists. Direct Federal taxes and inflation have eroded the family's spendable income by a full 13 percent, measured in constant 1973 dollars, they say.

From 1973 to 1983, before-tax income for this prototypical family (one earner employed full-time, year-round, with two dependent children) rose by $12,205 in nominal dollars. This 103 percent boost over the last decade brought the median family's earnings from $11,895 to $24,100.

However, over the same period, Federal taxes rose 129 percent, from $1,730 to $3,955, a jump of $2,225. Income taxes climbed a hefty 113 percent, increasing from $1,098 to $2,340. Social security taxes soared 156 percent, from $632 to $1,615, as ever more revenues were needed to pay for higher benefits and indexing of those benefits in an inflating economy.

While direct Federal taxes cut the family's current dollar gain by $2,225, its nominal gain was still $9,980 or 98 percent in the decade.

On top of this, the Consumer Price Index (CPI) more than doubled during the decade, bringing the purchasing power of each dollar down to 44 cents as compared to the 1973 dollar. All together, the family's after-tax real income was reduced by 13 percent.

Real purchasing power declined every year from 1976 to 1981, say Tax Foundation analysts. It edged up fractionally in 1982 and 1983. The purchasing power of this family, it is estimated, will be about 2 percent higher this year than it was in 1981. The gain reflects both the tax cuts in the Economic Recovery Tax Act of 1981 (ERTA) and the sharp drop in inflation over the last two years, according to the Tax Foundation.

Direct Federal taxes as a percent of income for the family reached the highest point in 1981, when taxes claimed 17.2 percent of income. In 1983, this tax bite is estimated at 16.4 percent of income.

The accompanying table gives details for the decade 1973-1983.

Median Family Incomes Before and After Direct Federal Taxes and Inflation
1973–1983

Year	Median family income[a]	Direct Federal taxes: Income tax[b]	Direct Federal taxes: Social security	Direct Federal taxes: Total	After-tax income: Current dollars	After-tax income: 1973 dollars[c]
1973	$11,895	$1,098	$ 632	$1,730	$10,165	$10,165
1974	13,004	1,267	761	2,028	10,976	9,888
1975	14,156	1,172	825	1,997	12,159	10,040
1976	15,016	1,388	878	2,266	12,750	9,953
1977	15,949	1,466	933	2,399	13,550	9,934
1978	17,318	1,717	1,048	2,765	14,553	9,918
1979	19,048	1,881	1,168	3,049	15,999	9,797
1980	20,586	2,143	1,262	3,405	17,181	9,267
1981	21,462[d]	2,267	1,427	3,694	17,768	8,680
1982	22,900[d]	2,338	1,534	3,872	19,028	8,761
1983	24,100[d]	2,340	1,615	3,955	20,145	8,832

[a]Median income for all families with one earner employed full-time, year-round.
[b]Married couple filing joint return, two children.
[c]Adjusted by Consumer Price Index of the Bureau of Labor Statistics.
[d]Estimated by Tax Foundation.
Source: U.S. Department of Commerce, Bureau of Labor Statistics; Treasury Department, Internal Revenue Service; and Tax Foundation computations.

$1.5 Billion Price Tag For U.S. Congress in 1983— Up 15 Percent Over 1982

Congress will spend $1.5 billion on itself in fiscal year 1983, Tax Foundation analysts report, based on current Budget estimates. That is a 15 percent ($201 million) increase over what Congress cost taxpayers last year. The 1984 Budget presented in January of this year reports the estimated cost of Congress in 1983 at $1,527.1 million, compared with actual spending of $1,362.5 million in fiscal year 1982, say Foundation economists.

Costs of the Legislative Branch are mushrooming. The 1983 estimate comes to more than twice the $726.2 million in spending recorded for Congress as recently as 1975. It was in 1976 that Tax Foundation first

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TAX FOUNDATION, INCORPORATED
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Federal Budget Outlays for the Legislative Branch by Unit
Selected Fiscal Years 1970–1983[a]
(Thousands)

Unit	1970	1975	1980	1982	1983
Total	$343,147	$726,191	$1,217,985	$1,362,490	$1,527,055
Congress, total	179,159	326,214	581,543	693,593	733,812
Senate	57,585	102,237	183,890	213,229	247,070
House of Representatives	108,279	178,988	324,569	375,241	397,131
Joint activities	13,295	44,989	73,084	105,123	89,611
Legislative agencies, total	163,988	399,977	636,442	668,897	793,243
Architect of the Capitol	18,797	50,894	89,496	109,879	121,826
Botanic Garden	620	998	1,583	1,801	2,383
Congressional Budget Office	—	—	12,101	13,632	14,963
General Accounting Office	69,857	125,941	201,192	229,827	249,957
Government Printing Office	34,141	121,436	115,747	91,237	109,783
Library of Congress	49,804	100,795	192,740	209,374	277,882
Office of Technology Assessment	—	2,723	11,131	11,394	13,690
U.S. Tax Court	2,972	11,028	9,703	11,399	14,547
Other	—	—	13,675	716[b]	1,028
Deductions for offsetting receipts	-12,203	-15,370	-10,926	-10,362	-12,816

[a]Data for 1983 are preliminary.
[b]Decline from 1980 reflects primarily the phasing out of the Temporary Commission on Financial Oversight of the District of Columbia, for which fiscal 1980 outlays are $11,622 thousand.
Source: Office of Management and Budget.

"Congress alone will cost the taxpayers $734 million in fiscal 1983."

Now Available

"Consumption Tax: An Idea Whose Time Is Coming," *Special Report*, April, 16 pp., $5.00.

"U.S. Tax Treatment of Foreign Source Income," *Federal Tax Policy Memo*, 4 pp.

Fiscal Policy Forum, "At Issue: The Balanced Budget Amendment," January, 6 pp.

Fiscal Policy Forum, "At Issue: Productivity," April, 6 pp.

"Needed: More Fiscal Responsibility," by Maynard H. Waterfield, *Special Report*, January, 4 pp.

"The Reagan Budget: 1984-1988," by Elsie M. Watters, *Special Report*, March, 4 pp.

"The Federal Fiscal Dilemma: Is There a Solution?" *Proceedings* of Tax Foundation's 34th National Tax Conference, 1982, 28 pp., $7.50.

"Unemployment Insurance: Trends and Issues," *Research Publication* No. 35, 96 pp., $5.00.

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(COST OF CONGRESS, from page 1)

addressed the issue of the cost of Congress, in "The Legislative Branch—The Next Billion Dollar Bureaucracy." The prediction became a reality in 1978 when Federal outlays for the Legislative Branch broke the $1 billion mark for the first time. That year, the tab for the Senate, the House of Representatives, and related agencies cost taxpayers $1.05 billion for the fiscal year.

In 1980 and 1981 the cost of Congress edged up to $1.2 billion a year. Four months into fiscal 1982 the cost had been pegged at over $1.5 billion for that year. Later figures released this year, however, indicate that the $1.5 billion tab will not be reached until the current fiscal year, which ends September 30, 1983.

Congress alone will cost the taxpayers $734 million in fiscal 1983—$247 million for the Senate, $397 million for the House of Representatives, and $90 million for joint activities. Another $793 million will be spent by various legislative agencies, up from $669 million in 1982—a rise of nearly 19 percent.

The Library of Congress is budgeted to spend $278 million in 1983, compared to $209 million in 1982 (up 33 percent); the General Accounting Office, $250 million, compared to $230 million (up 9 percent); the Architect of the Capitol, $122 million, compared to $110 million (up 11 percent); and the Government Printing Office, $110 million, compared to $91 million (up 20 percent).

Not all areas are experiencing cost increases, however. Congressional spending in several categories has been reduced in recent years. From 1980 to 1981 Government Printing Office costs were cut by $39 million, more than 33 percent, in the wake of sharp reductions in the number of government publications printed. Unfortunately for budget-watchers, however, rising costs in the last two years have now whittled the 1980-1983 reduction from this source down to a mere 5 percent. A more lasting saving resulted from the expiration of a Temporary Commission on Financial Oversight of the District of Columbia, which had cost taxpayers $11.6 million in fiscal year 1980.

Even bigger reductions among single items lie ahead with the completion of construction on the new $137 million Hart Senate Office Building. Construction of the building, spread over 10 years, had cost $41.2 million in 1981. Outlays in 1983 are pegged at $13.5 million, and 1984 costs will hit only $2.9 million.

Although Budget documents do not provide separate data on Legislative salaries, this component makes up a substantial share of all costs of Congress. As of October 1982 (latest reported) there were 38,464 persons on the Legislative Branch payroll, including Members of Congress. Some 19,171 of the employees were assigned to Congress as distinct from legislative agencies.

The largest agency employers were the Government Printing Office (5,965 employees), the Library of Congress (5,245), and the General Accounting Office (5,212). Total employment in the Legislative Branch has been relatively stable in recent years at 38,000-39,000, but declined by 730 persons, or 2 percent, between October 1980 and October 1982. Since 1970, however, employment has risen by 25 percent.

The budget submitted in January of this year projects another $56 million increase in outlays for the Legislative Branch in fiscal 1984.

The accompanying table provides further details.

U.S. Debt Grows $1,000/Person/Year

The Federal government was able to live within its legal credit limits for the first eight months of its 1983 fiscal year, but not a moment longer. Testifying before Congress in May, Treasury officials said that the debt limit had to be raised immediately, because Federal debt would reach $1.320 trillion by June 1, exceeding the $1.290 trillion lid approved by Congress last fall.

At present rates, the Federal debt is increasing $1,000 per year per person, Tax Foundation economists say.

A $99 billion increase—to $1.389 trillion—was approved in late May and signed by the President almost immediately. In raising the ceiling, Congress also decided that it was time to abandon the now mostly symbolic "permanent" debt limitation of $400 billion that had been in effect since 1972. Since then, lawmakers have simply approved a "temporary additional" limitation on 22 separate occasions, each time lifting the "temporary" addition to a higher level.

(Continued on page 4)

Federal Deficits, Debt Outstanding, and Related Measures
Selected Fiscal Years 1975–1984[a]
(Billions, except per capita)

Year	Receipts	Outlays[b]	Deficit[b]	Interest on the public debt	Debt outstanding[c] Total	Debt outstanding[c] Per capita
1975	$279.1	$332.3	$ -53.2	$ 32.7	$ 544.1	$2,519
1976	298.1	371.8	-73.7	37.1	631.9	2,898
T.Q.[d]	81.2	96.0	-14.7	8.1	646.4	2,957
1977	355.6	409.2	-53.6	41.9	709.1	3,222
1978	399.6	458.7	-59.2	48.7	780.4	3,496
1979	463.3	503.5	-40.2	59.8	833.8	3,693
1980	517.1	590.9	-73.8	74.8	914.3	4,005
1981	599.3	678.2	-78.9	95.5	1,003.9	4,355
1982	617.8	745.7	-127.9	117.2	1,147.0	4,929
1983	598.3	825.3	-227.0	126.8	1,392.0	5,929
1984	653.7	858.3	-204.7	143.1	1,622.6	6,849

[a]Data for 1983 and 1984 are based on estimates presented by the Administration in April 1983.
[b]Includes activities of off-budget agencies; no receipts are attributable to these transactions.
[c]End of fiscal period.
[d]Transition quarter.
Source: Office of Management and Budget, Department of Commerce, and Tax Foundation computations.

THE FRONT BURNER

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"The Nose of the Camel"

There is a notion which has gained acceptance in Washington over the last 20 years that, because an idea is worthy and doable, it should be done and paid for by the public. On this questionable premise rests the vast social welfare apparatus now burdening the taxpayer.

Food stamps began in the Kennedy Administration as an experiment to improve child nutrition. The program has grown 1,000 percent, from $13 million in fiscal year 1961 to $12.5 billion in fiscal year 1983. What is more, the stamps are now viewed as a "social contract" item, routinely increased every year in step with population and the cost of living.

The same holds for medical aid. Welfare medical-care payments started small, totalling $48 million in 1951. Medicaid for fiscal 1984 is budgeted at $21 billion. Medicare benefits started at $2.3 billion in fiscal 1967. Then—in 1967—it was estimated that Medicare would cost about $6 billion by 1984. In actuality, the proposed 1984 Medicare budget is $81 billion.

Newly arrived on the scene are proposals for health insurance and housing subsidies for the long-term unemployed. Both the House and the Senate have addressed each of these questions. Proposed spending levels range from $5.4 billion in the House and $1.8 billion in the Senate for health assistance, and $760 million in the House and $750 in the Senate for mortgage help to the long-term unemployed who face foreclosure.

Skip the details, because it is not a single bill or a particular method of providing such aid that is at question here. The issue is that we once again face well-meaning programs, begun at small levels of spending, which will surely run amok, if past experience means anything.

Such programs are like the nose of the camel. Once the nose is in the tent, the whole camel soon follows. So too, once the policy option of helping unemp. yed persons cover health insurance costs and mortgage payments is enacted into law, the huge budgetary outlays will be impossible to stop.

If you have any doubts, look at food stamps and Medicaid/Medicare costs. Look at the $200 billion deficits being projected for the next several years. Most of that shortfall can be traced to the unrestrained growth of social welfare programs as a percentage of the Federal budget over the last 20 years.

In short, beware the nose of the camel.

"The issue is that we once again face well-meaning programs, begun at small levels of spending, which will surely run amok, if past experience means anything."

Tax Foundation, Incorporated

"If the $33.8 billion had simply been confiscated, Uncle Sam would have netted an additional $12.7 billion, enough to run the Federal government for about 8 days."

(DEBT LIMIT, from page 3)

Without Congressional action the previous debt limit of $1.290 trillion would have reverted to the $400 billion permanent limit by September 30, 1983.

In asking for the increase, a Treasury spokesman told Congress that unless the ceiling were approved, the Administration would have to choose which of its bills to pay—social security, payroll, unemployment checks, or defense contracts—or "indeed, whether, for the first time in history, the United States will default on its obligations."

Based on current estimates by the Administration, the debt ceiling will have to rise by another $230 billion or so—to more than $1.6 trillion—by the end of the forthcoming fiscal year (September 30, 1984).

On a per capita basis, debt is projected at $6,849 at that time, almost twice what it was as recently as 1978.

Federal Individual Income Tax Generated at Each Tax Rate
Income Year 1980

Tax rate[a] (percent)	Number of returns with any tax at rate[b] (thousands)	Tax base taxed at rate (millions)	Tax generated at rate (millions)	Percent of total		
				Returns	Tax base	Tax generated
Zero	88,105	234,840	$ 0	100.00	18.47	.00
14	76,121	124,734	17,463	86.40	9.81	6.83
16	69,129	111,623	17,860	78.46	8.78	6.98
18	62,815	193,011	34,742	71.30	15.18	13.58
21	62,026	171,254	35,348	70.40	13.47	13.82
24	39,697	119,879	28,626	45.06	9.43	11.19
28	27,061	83,261	22,988	30.71	6.55	8.99
32	18,812	67,894	21,427	21.35	5.34	8.38
37	11,275	43,747	15,822	12.80	3.44	6.19
43	6,127	37,809	16,038	6.95	2.97	6.27
49	3,227	25,449	12,313	3.66	2.00	4.82
50	468	23,983	11,992	.53	1.89	4.69
54	767	9,120	4,925	.87	.72	1.93
59	497	5,706	3,300	.56	.45	1.29
64	295	5,830	3,717	.33	.46	1.45
68	118	2,818	1,916	.13	.22	.75
70	79	10,376	7,264	.09	.82	2.84
0-70	88,105	1,271,335	255,740	100.00	100.00	100.00

[a]Data for heads of households and unmarried individuals are combined with data in brackets for next higher rate.
[b]Most returns have a tax base taxed at more than one rate. For example, a married couple's taxable income (adjusted gross income minus exemptions and itemized deductions in excess of $3,400) of $7,600 in 1980 was taxed as follows: first $3,400 at zero rate (= $0), next $2,100 at 14% (= $294), next $2,100 at 16% (= $336), and the total tax was $630.
Source: Treasury Department and computations by Tax Foundation

U.S. Could Run for 8 Days By Taxing Top Earners 100%

One of the unexploded myths of the U.S. progressive tax system is that high taxes on top earners generate significant amounts of revenue. Tax Foundation's on-going research into tax dollars brought in at various bracket rates continues to show that this is not so.

About 88 million Americans filed tax returns in 1980. Nearly 1.8 million showed income taxed at marginal rates above 50 percent, according to the latest data available from the U.S. Treasury. This represented 2.0 percent of returns filed.

These top payers had $33.8 billion in taxable income subject to rates higher than 50 percent—2.7 percent of the total Federal income tax base. The Federal Treasury collected nearly two-thirds of that income—$21.1 billion—from these taxpayers. It represented 8.3 percent of all 1980 Federal income tax revenues.

If the $33.8 billion had simply been confiscated (taxed at 100 percent), Uncle Sam would have netted an additional $12.7 billion, enough to run the Federal government for about 8 days.

The costs break down as follows: Federal spending—off-budget, as well as on-budget—came to $590.9 billion in 1980. That's about $1.6 billion a day.

In 1980, 468,000 returns fell into this category, with average income of $51,250 and average taxes of $25,620 per return. At that time, rates ranging from 54 to 70 percent were imposed on so-called "unearned" income only. Since 1972, "earned" income has been taxed at a top marginal rate of 50 percent.

In tax year 1980, rates above 50 percent were levied on income above $41,500 for single taxpayers, above $60,000 for married persons filing joint returns, above $44,700 for heads of households, and above $30,000 for married persons filing separate returns.

In 1981, Congress approved a reduction in the top rate applying to "unearned" income from 70 percent to 50 percent, effective in 1982.

The accompanying table gives details.

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TAX FOUNDATION'S MONTHLY VOL. 27, NO. 6 JULY 1983

TAX·FEATURES

$1.3 Trillion Spending in FY83 By All Levels of Government in U.S.

Federal, state, and local governments in the United States will spend an estimated $1.3 trillion during the current fiscal year, according to Tax Foundation economists. This is $103 billion (8.6 percent) more than they spent in fiscal year 1982.

The 1983 total breaks down to $5,587 per U.S. resident, and to $15,345 per household.

The Federal government will account for nearly two-thirds of the spending—$864.8 billion, including grants-in-aid to states and localities. Subnational governments will spend the rest—an estimated $435.5 billion from their own revenue sources. Federal outlays in 1983 are expected to grow by 10.1 percent, considerably above the 5.9 percent growth projected for state and local governments by analysts at the Tax Foundation.

Between 1950 and 1970, all government spending rose at an average annual rate of around 8 percent. Spending growth accelerated during the 1970s to 11.2 percent. In the first three years of the 1980s, increases have dropped back slightly to average 10.7 percent a year.

In the last seven years alone, total government spending has more than doubled, rising from $625.1 billion in 1976 to an estimated $1,300.3 billion in 1983. During the same period Federal spending has increased by 122 percent, and state and local spending, by 85 percent.

Ever since 1950, spending by governments has tended to outpace growth in the overall economy, as measured by Gross National Product (GNP). Government expenditures moved up from 21.3 percent of GNP in 1950, to 26.9 percent in 1960, 31.6 percent in 1970, and to 35.5 percent of GNP in calendar year 1982. Over the past 12 years state-local spending has declined slightly in relation to GNP, from 11.0 percent in 1970 to 10.5 percent in 1982. On the other hand, Federal spending has risen from 20.6 percent of GNP in 1970 to 25.0 percent in 1982, the latest year reported.

On a per capita basis, government expenditures will rise from $2,886 in 1976 to an estimated $5,587 in the current fiscal year, or by 94 percent. Because the number of households is growing faster than population generally, the rise for households will be somewhat less—79 percent, from $8,579 in 1976 to $15,345 during the current year.

Additional details on total spending by level of government, and per capita and per household data are shown in the table on page 4.

The other article on this page discusses changes in the composition of government spending since 1960.

Social Security Claims 16¢ of Each Dollar Spent By U.S. Governments

The Federal social security system became the most costly of all government programs in fiscal year 1981, the latest for which full data have been reported. Expenditures for the Old-Age, Survivors, Disability, and Health Insurance (OASDHI) program totaled $177.5 billion, accounting for 16.0 cents out of every dollar spent by Federal, state, and local units, up from 7.1 cents in 1960, according to analysis by Tax Foundation economists.

Spending for national defense was the second largest budget item, accounting for 15.7 cents of the spending dollar in 1981, down from 32.3 cents in 1960 and 25.3 cents in 1970. Education was the third most costly government function, claiming 14.2 cents of every spending dollar in 1981, up from 12.8 cents in 1960 but

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How Federal, State, and Local Governments Spend Each Dollar of Public Funds

Selected Fiscal Years 1960-1981

Function	Cents per dollar of total spending 1960	1970	1981
Social security programs (OASDHI)	7.1	10.8	16.0
National defense[a]	32.3	25.3	15.7
Education	12.8	16.7	14.2
Social services and income maintenance[b]	8.5	10.7	13.1
Interest on general debt	6.2	5.5	8.8
Environment and housing	5.4	4.4	5.2
Transportation	7.6	6.2	4.2
Utilities and liquor stores	3.4	2.8	3.9
Government employee retirement	1.4	1.9	3.0
Public safety	1.8	2.0	2.2
Government administration	1.8	1.9	2.0
Postal service (Federal)	2.5	2.3	1.8
Sanitation	1.1	1.0	1.3
All other	7.9	8.3	8.4
Exhibit (billions): Total spending	$151.3	$333.0	$1,109.8

[a]Includes international relations.

[b]Includes public welfare (cash assistance to the needy and vendor payments under Medicaid), hospitals, health, and unemployment insurance benefits.

Source: *Facts and Figures on Government Finance*, 1983, Tax Foundation (forthcoming); basic data from U.S. Department of Commerce, Bureau of the Census.

Individual Income Taxes Top Revenue Raiser in U.S. —30.9¢ of Every $1 Taken

"In fiscal 1981, income taxes provided 43 cents out of every dollar raised by the Federal government."

Individual income taxes have been the biggest single revenue provider for U.S. governments since 1944. Then they accounted for 30.9 cents of every dollar of revenue raised. Perhaps by coincidence, Tax Foundation researchers say, the share was exactly the same—30.9 cents—in fiscal year 1981, the latest for which full tax data for all units have been reported. In 1960, the contribution of income taxes was slightly lower—28.2 cents per revenue dollar. The Federal government, 40 states, the District of Columbia, and local governments in 11 states now impose a broad-based personal income tax. In fiscal 1981, income taxes provided 43 cents out of every dollar raised by the Federal government, 17 cents per dollar for the states, and about 3 cents for local units.

The second leading source of government revenues, and also the most rapidly rising, is the Federal social security tax, which finances the Old-Age, Survivors, Disability, and Health Insurance program. In 1981, social security taxes brought in 15.2 cents of every dollar of revenue raised by all governments (24.8 cents per dollar of Federal revenues), in contrast to 7.0 cents per dollar in 1960.

The role of state and local general sales taxes also grew rapidly during the last two decades—from 3.5 cents per dollar of revenue for all governments in 1960 to 5.2 cents in 1981. The Federal government has never imposed a general sales tax, but the tax is an important source of revenue for 45 state governments, the District of Columbia, and for hundreds of local governments in over two dozen states. In 1981, general sales taxes provided 19 cents of each revenue dollar raised by the states and 5 cents of every local revenue dollar.

Sources of revenue with a declining role in the total revenue structure during the last two decades include corporation income taxes; selective sales taxes on such commodities as gasoline, tobacco, and alcohol; and property taxes.

Corporate income taxes furnished 14.8 cents per total revenue dollar in 1960 and only 7.0 cents in 1981. The role of selective sales taxes declined from 12.5 cents in 1960 to 7.3 cents per dollar of revenues raised by all governments in 1981. During the same period, the share of property taxes in the revenue dollar fell from 10.7 cents to 7.0 cents.

The drop in the significance of property taxes was not so pronounced for the total revenue structure, but was quite severe for local governments. In 1981 property taxes comprised 41 cents of every dollar raised by local units, down from 58 cents in 1960. Property taxes are not levied at all by the Federal government and are used only to a slight extent by the states, say Tax Foundation economists.

While taxes still account for the lion's share of public revenues, their contribution to the total revenue dollar dropped from 82.7 cents in 1960 to 77.6 cents in 1981. Nontax revenues—especially current charges and miscellaneous general revenues, including interest earnings of governments on their security holdings—rose from 17.3 cents per dollar of revenues raised in 1960 to 22.4 cents in 1981.

The accompanying table provides further details.

How Federal, State, and Local Governments Raise Each Dollar of Public Funds

Selected Fiscal Years 1960-1981

Source	Cents per dollar of total revenue 1960	1970	1981
Tax revenues	82.7	82.4	77.6
Property	10.7	7.3	7.0
Individual income	28.2	30.7	30.9
Corporate income	14.8	8.4	7.0
General sales	3.5	5.5	5.2
Selective sales and excises	12.5	6.5	7.3
Social security (OASDHI)	7.0	15.0	15.2
Other taxes[a]	6.0	9.0	5.0
Nontax revenues	17.3	21.8	22.4
Current charges	8.1	8.6	8.4
Miscellaneous general revenue[b]	3.3	6.7	7.4
Employee retirement	1.9	3.1	3.2
Utilities and liquor stores	3.2	2.7	2.8
Other nontaxes	.8	.7	.6
Exhibit (billions):			
Total revenues	$153.1	$333.8	$1,075.4
Surplus (+) or deficit (−)	+$ 1.8	+$ .8	−$ 34.4

[a]Includes death and gift, motor vehicle and operators' license, unemployment compensation, and miscellaneous taxes.

[b]Includes interest earnings, special assessments, sale of property, and others.

Source: *Facts and Figures on Government Finance*, 1983, Tax Foundation (forthcoming); basic data from U.S. Department of Commerce, Bureau of the Census.

(SOCIAL SECURITY SPENDING, from page 1)

somewhat below the 16.7 cents share it took in 1970.

Social services and income maintenance ran close behind, ranking fourth at 13.1 cents of each spending dollar. (This included public welfare—both cash payments for living allowances and Medicaid benefits—health and hospitals, and unemployment insurance.) By comparison, 8.5 cents of each dollar went for these purposes in 1960, and 10.7 cents in 1970.

Interest on general debt comprised the next largest spending item, requiring 8.8 cents of each dollar. This compared with 6.2 cents in 1960, and 5.5 cents in 1970. (Among Federal expenditures only, such interest payments now rank as the third largest spending item.)

The five most expensive government functions—social security, national defense, education, social services and income maintenance, and interest on general debt—together claimed nearly 68 cents of every dollar of government spending in fiscal year 1981.

Government employee retirement, while a smaller part of the total than the items above, has shown a steady rise from 1.4 cents of each dollar spent in 1960 to 1.9 cents in 1970, and 3.0 cents in 1981.

The table on page 1 gives further details.

Monthly Tax Features

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Budget = 17¢ Cuts Per $1 Tax Hike

On June 23, the First Concurrent Budget Resolution for fiscal year 1984 passed both Houses of Congress. Actually, two versions of the Budget were contained in the resolution assembled by the conference committee and adopted by both the Senate and the House of Representatives, Tax Foundation analysts point out.

One version calls for total spending of $849.5 billion, revenues of $679.6 billion, and a deficit, assuming these targets are met, of $169.9 billion. Under this budget, fiscal year 1984 spending will be $42.1 billion higher than this year, and revenues will increase by $75 billion, including projected new taxes.

But that's only half the story.

Another version of the Budget, preferred by the House but presented to and passed by the Senate, contains a "reserve fund" of $8.5 billion. Budget authority and outlay targets in this version embrace several new initiatives in domestic programs that would be triggered only through the enactment of authorizing legislation.

(Continued on page 4)

Congressional Decisions in First Concurrent Budget Resolution for 1984

Fiscal Years 1984-1986

(Billions)

Item	1984	1985	1986	Total 1984-86
Budget totals				
Outlays	$ 849.5	$ 906.8	$ 963.0	$2,719.7
Revenues	679.6	750.5	835.8	2,265.9
Deficit	169.9	156.3	127.2	453.4
Reconciliation[a]				
Outlays	-2.8	-3.9	-5.5	-12.3
Revenues	12.0	15.0	46.0	73.0
Reserve fund	8.5	3.5	2.0	14.0
Debt limit (end of year)	1,614.6	1,830.1	2,022.8	N/A

[a]Instructions by the full House and Senate to legislative committees to reduce current-law outlays or raise current-law revenues by the amounts indicated, in order to meet targeted budget totals.

Source: Conference Report, First Concurrent Resolution on the Budget—Fiscal Year 1984, June 21, 1983.

THE FRONT BURNER

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"Bumper Car Tax Policy"

Remember trips as a youngster to the amusement park? Remember the bumper cars? Maybe it was the feeling of power, of being in the driver's seat. Maybe it was childish glee at being able to unleash hostility without fear of reprimand. Whatever their appeal, bumper cars featured prominently in our youth.

Sometimes the taxwriters here in Washington seem to have a bumper car mentality when it comes to raising revenues. Time was when this nation had a consistent, on-going approach to tax policy. Long-term consequences were weighed in any deliberations. Experience counted. Bipartisanship was the rule. As Representative Barber Conable, a past master of policymaking, put it, "The tent was big enough for everyone to get under."

In 1981, a carefully thought out tax act was framed and passed. Most of what it contained reflected years of thought and work, years of dialogue between legislators and analysts inside and outside government. Despite some flaws, the Economic Recovery Tax Act of 1981 (ERTA) was, on the whole, a well-crafted piece of tax legislation. It was the last of the breed.

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), by contrast, stands as the spawn of what I call bumper car tax policy. As the recession deepened, $98 billion became the magic number. No serious thought was given to $98 billion in spending reductions. Only "revenue enhancements" were considered. With eyes focused on the bottom line, tax writers charged after likely targets. Chalk some of it up to the headiness of power; some of it, to the glee of creating a ruckus in the henhouse; some of it, to sheer partisanship.

In any event, TEFRA emerged as a policyless tax act, to coin an inelegant phrase. The lawmakers simply bounced off one revenue option after another until they hit the $98 billion level.

The same hit-or-miss approach is now underway for 1984, although the magic number this year is $12 billion, since there is so little left to take. As in 1982, there is the same lack of consistent policy, the same indifference to what makes an economy tick, the same distaste for the hard mental work that thoughtful tax legislation demands. Just the $12 billion bottom line commands attention.

It's a shame. Bumper cars in the hands of little boys are harmless. Bumper car tax policy in the hands of election-bound lawmakers can cost taxpayers a lot of money.

"Time was when this nation had a consistent, on-going approach to tax policy."

(GOVERNMENT SPENDING, from page 1)

Federal, State, and Local Government Expenditures[a]
Selected Fiscal Years 1950-1983

Fiscal year	Amount (billions) All governments	Federal	State and local	Total expenditures Per household	Per capita
1950	$ 70.3	$ 44.8	$ 25.5	$ 1,614	$ 466
1960	151.3	97.3	54.0	2,866	847
1965	205.7	130.1	75.6	3,581	1,067
1970	333.0	208.2	124.8	5,252	1,643
1975	560.1	340.5	219.6	7,875	2,612
1976	625.1	389.9	235.2	8,579	2,886
1977	680.3	430.6	249.7	9,176	3,111
1978	745.4	477.8	267.6	9,804	3,373
1979	832.4	535.7	296.7	10,764	3,726
1980	958.6	615.4	343.2	11,867	4,243
1981	1,109.8	717.4	392.4	13,474	4,859
1982[b]	1,196.9	785.8	411.1	14,329	5,192
1983[b]	1,300.3	864.8	435.5	15,345	5,587

[a] Grants-in-aid are counted as expenditures of the first disbursing unit.
[b] Estimated by Tax Foundation.
Source: Basic data from U.S. department of Commerce, Bureau of the Census; computations by Tax Foundation.

"When it comes to making Federal money flow, the debt limit is the controlling factor."

(BUDGET RESOLUTION, from page 3)

In other words, Congress has to explicitly decide to spend the money. However, Congress seems to be anticipating that it will do so.

While the widely publicized deficit number does not take into account this extra $8.5 billion in spending, the public debt level adopted by both the Senate and House does include these outlays. When it comes to making Federal money flow, the debt limit is the controlling factor. The deficit number is irrelevant.

Setting aside the "reserve fund," both versions of the Budget contain binding directives to certain committees to enact legislation reducing spending levels that would automatically occur, absent congressional action. The total reductions called for are $2.8 billion in fiscal year 1984, $3.9 billion in 1985, and $5.5 billion in 1986—a three-year total of $12.3 billion. Note that these are reductions in the amounts of growth, not net reductions of spending from fiscal 1983.

Independent of these spending cuts is another directive to the tax-writing committees to raise revenues by $12 billion in 1984, $15 billion in 1985, and $46 billion in 1986—$73 billion in new taxes over three years.

By voting one budget resolution with two versions of the Budget, fiscal years 1984-86, Congress has enabled itself to promise 17 cents worth of spending cuts for every $1 of tax hikes—unless it decides to wash out even this modest savings by spending the reserve fund.

New "Facts and Figures" Updates Fiscal Profile

Facts and Figures on Government Finance is Tax Foundation's widely used handbook of public finance data. The 22nd edition in a biennial series stretching back to 1941 is scheduled for fall publication. "Facts and Figures" offers a varied portrait of United States tax, fiscal, and economic life in some 283 tables, 38 of them brand new in this edition. Among the highlights are:

Industrial production rose by 37.6 percent between 1967 and 1982 for all manufacturing industries combined. Output of nondurables rose 56.2 percent; for durable manufacturing goods the rise was only 24.7 percent.

* * *

Taxes on goods and services contribute a smaller share of total tax revenues to governments in the United States (16.6 percent) than in any other major industrial nation except Japan (16.4 percent). On the other hand, property taxes in the United States provide a larger portion of tax revenues (10.04 percent) than in any other major country except the United Kingdom (12.09 percent).

* * *

Average yields of U.S. Treasury bills (new issues, 3-month) reached double-digit levels for the first time in 1979—10.041 percent; it was not until 1956 that yields were as high as 2 percent.

* * *

In the last thirty-three years (since 1950), U.S. production (Gross National Product in constant dollars) declined in seven years; productivity (output per person-hour) fell in three years (1974, 1979, and 1980); and consumer prices fell only once (four-tenths of 1 percent in 1955).

Toward better government Founded 1937

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FEDERAL TAX POLICY MEMO

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Evolution of the Federal Tax System: 1954-1983

By William C. Penick

The last quarter of a century, roughly the mid-1950s to date, has been a period of most frequent and dramatic changes in the Federal tax system. Most observers of the Federal tax scene apply three, or possibly four, criteria for evaluating proposed tax legislation. These are:

(1) Fairness or equity;

(2) Simplicity or understandability to the average taxpayer;

(3) Economic impact, including incentives or disincentives for savings, investment, and other types of economic behavior; and

(4) Efficiency of the change—whether it will accomplish its objective without creating undue administrative or compliance problems.

EARLY HISTORY

While we had brief experience with Federal income taxes in the 19th century, the "modern" income tax system traces its roots to 1913. There were several revenue acts during the next four decades, but the 1954 Act was by far the most important attempt by Congress to put our income tax laws together in a cohesive and logical package. Whether they succeeded or not is obviously debatable.

Once the 1954 Act was in place and we had a chance to live with it for a few years, Congress commenced a program of both substantive change and fine tuning, largely directed toward concerns about fairness or equity, which was translated into identifying perceived loopholes and unintended benefits and trying to eliminate them. This led to a series of revenue acts commencing in 1962 and extending for nearly 15 years, culminating in the Tax Reform Act of 1976. The principal acts falling into this period were the Revenue Acts of 1962 and 1964, the Tax Reform Act of 1969, the Revenue Act of 1971, and the Tax Reform Act of 1976.

The **Revenue Act of 1962** was the most significant piece of tax legislation to follow the 1954 changes. Its stated purposes were to: stimulate economic growth in the United States; improve our competitive position abroad; raise our standard of living at home; and improve the "equity" of our tax structure.

To accomplish the first objective, the investment tax credit was introduced into the Code. To achieve the latter, travel and entertainment expenses were restricted; bad debt provisions for financial institutions were reduced; changes were made in the taxation of foreign operations, including the taxation of Americans working abroad; depreciation recapture was adopted for depreciable assets other than real estate; and changes were made to improve compliance.

A major change in the corporate and individual rate structure occurred in the **Revenue Act of 1964**. The range in individual tax rates during the latter stages of World War II was 23% to 94%. The top rate came into play at $200,000 for a joint return. There was an overall ceiling on the total tax burden of 90% for 1944 and 1945, and ranging from 77% to 88% during the Korean War.

A rate structure ranging from 20% to 91% was in effect until 1964 when it was reduced to 16% to 77%, and to 14% to 70% commencing in 1965. These rates remained in place until the 1981 Act, except for temporary surtaxes in the late 1960s. The top corporate rate was reduced from 52% to 50% in 1964, and to 48% in 1965.

The **Tax Reform Act of 1969** was intended to be a substantive and comprehensive reform of our income tax laws. To a considerable extent, it was motivated by disclosures that a number of individuals with high levels of adjusted gross income ($200,000 or more) were paying little or no taxes.

The investment tax credit enacted seven years earlier was repealed. The increased tax revenues anticipated through repeal of the investment credit (over $8 billion over three years) and other "reform" measures were more than offset by the reduction in the tax burdens of lower income groups. The tax reform objectives were achieved largely through imposition of the tax preference system, another blow for simplification. Tax relief for lower income groups was achieved primarily through small rate reductions and increases in the standard deduction and low-income allowance. In addition, a top rate of 50% on earned income was adopted.

The stated purposes of the **Revenue Act of 1971** were to provide a balanced program of tax reductions for individuals and tax incentives for business. Key members of Congress expressed concern about high unemployment, the impact of inflation on taxes, the need to modernize productive facilities, and our declining level of exports.

One of the major provisions in the 1971 Act was restoration of the investment tax credit under a new name, "Job Development Investment Credit." To stimulate exports, the DISC approach was adopted. Individual tax reductions were created by increases in personal exemptions and the standard deduction. A stated reason for the individual changes was to alleviate the impact of inflation, sometimes referred to as *Ad Hoc* Indexation, or *Political* Indexation.

The **Tax Reform Act of 1976**, over three years in the making, was intended to review the entire tax structure to eliminate perceived abuses and unintended benefits. Extensive hearings were held on tax shelter schemes, the treatment of foreign source income, the regulation of tax professionals, and many administrative provisions.

When completed, the Act contained such things as:

- ☐ Capitalization of construction period interest and taxes;
- ☐ Recapture of depreciation on real property;
- ☐ Strengthening the maximum tax on preferences;
- ☐ Restrictions on DISC (incremental approach); and

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- ☐ Tougher rules on foreign tax credits for foreign oil and gas operations.

Another part of the 1976 Act was the elimination of many so-called deadwood provisions that had accumulated in the Internal Revenue Code over many years. Nearly 150 sections of the Code were repealed and major deletions were made in 850 others.

Following the 1976 Reform Act, Congress began to show more concern about economic issues and the impact of the tax system on savings and investment. The next two major pieces of legislation were the **Revenue Act of 1978** and the Economic Recovery Tax Act (ERTA) of 1981. Both of these tax bills made significant changes intended to encourage savings and investment, to recognize the impact of inflation on the tax system, and generally to stimulate the economy.

The centerpiece of the 1978 Act was the major reduction in capital gains taxes. Ironically, the capital gains changes originated from proposals made by the Carter Administration that would have increased the level of taxation. Congress quickly rebelled over this proposal, as well as a number of others recommended by the Administration, and the final product went in the other direction. From a theoretical top rate of nearly 50% on long-term gains, the maximum rate dropped to 28%.

Aside from the capital gains changes, individual tax reductions were accomplished through widening tax brackets and changes in the zero bracket amount, formerly called the standard deduction.

At the business level, the corporate tax rate was reduced from 48% to 46% with a graduated structure from 17% to 46% up to $100,000 of taxable income. The investment tax credit was liberalized, and the rate (10%) made "permanent," and increased incentives were enacted for rehabilitating older structures. The minimum tax on tax preferences for individuals was changed by removing capital gains as a preference item and subjecting them to a new alternative minimum tax in place of the add-on scheme previously applicable.

ECONOMIC RECOVERY TAX ACT OF 1981 (ERTA)

From a conceptual viewpoint, ERTA was probably the most important piece of tax legislation we have seen in a quarter of a century. It was the first major tax bill under the Reagan Administration. It made dramatic changes in our system for cost recovery, investment incentives, overall tax rates, recognition of inflation, and estate and gift taxes. As its title suggests, its principal objectives were to create incentives for economic development and to reduce or eliminate disincentives for savings and investment.

The Act started with a fairly simple program proposed by the Administration that would have reduced individual taxes over a three-year period by roughly 30% and stimulated business investment through a new cost recovery system, essentially the so-called 10-5-3 approach.

With a Republican-controlled Senate and a Democratic-controlled House, however, consideration of the Administration proposals quickly evolved into a political bidding contest. The finished product went far beyond the initial proposals and, even though ultimately backed by the President, it probably went beyond what he and his top advisors really wanted.

Among other things, ERTA:

- ☐ Reduced the top individual rate to 50% on all types of income and the entire rate structure by about 25% over three years;
- ☐ Indexed individual tax brackets commencing in 1985;
- ☐ Created a new cost recovery system (ACRS) for depreciating business assets;
- ☐ Permitted a tax credit for "incremental" research and development expenditures; and
- ☐ Provided major reduction in estate and gift taxes.

Even though its principal business provisions were slanted toward encouraging capital investment, business groups generally, both capital and labor intensive, rallied behind the program and actively supported it. This was caused in large part by the President's personal appeal to leading business groups, and broadly based support was generated.

TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982 (TEFRA)

The driving force behind the 1982 Act was concern over rising Federal deficits. This led to the reexamination of major portions of ERTA and a redirection of tax policy toward loophole closing and eliminating perceived abuses.

Essentially, TEFRA took back many of the benefits of ERTA. It provided the Internal Revenue Service a new arsenal of weapons to seek compliance with existing tax laws. It attempted to address abuses involving corporate mergers and acquisitions and employee retirement plans. Its dominant objective, however, was to generate tax revenues.

Among other things, TEFRA:

- ☐ Reduced medical and casualty loss deductions;
- ☐ Expanded the alternative minimum tax system;
- ☐ Reduced benefits from ACRS and the investment tax credit;
- ☐ Repealed safe harbor leasing;
- ☐ Tightened rules for completed contract method;
- ☐ Enacted changes in tax rules for mergers and acquisitions;
- ☐ Made major changes in pension programs;
- ☐ Reduced possessions' corporation benefits, primarily Puerto Rico;
- ☐ Increased taxes on certain life insurance companies; and
- ☐ Adopted several provisions intended to improve compliance with tax laws, including greater penalties for underpayment of tax, increased information reporting, withholding on payments of dividends and interest.

Contrary to strong business support for the 1981 Act, the development of TEFRA divided the business community. The net result was that most business groups were ineffective in opposing major changes that were adverse to their interests.

In the final analysis, the President again put his neck on the line and, through his personal persuasion, prevailed upon Congress to pass a package that I suspect he and many of his top advisors did not really like. However, the size of anticipated budget deficits led to the enactment of many provisions that are distasteful, to say the least, to major segments of the taxpaying population.

Finally, while the reductions under ERTA were divided roughly 80%-20% between individual and business taxpay-

ers, increases under TEFRA went in the other direction. More than half of the benefits under ERTA for business were repealed by TEFRA.

GRADING 25 YEARS OF TAX LEGISLATION

We noted earlier the criteria that are usually applied to evaluate tax proposals. If we use them to grade the bills we have discussed earlier, either separately or collectively, and on a scale of 1 to 10, I would give Congress no better than a "6." Some bills were better than others, but none deserve very high marks. ERTA probably rates an "8."

With respect to "equity and fairness," assuming we can agree on what those terms really mean, some areas of abuse have been modified or eliminated over the last 25 years. For example, it is more difficult today to structure flimsy tax shelter arrangements, where a taxpayer can achieve huge writeoffs in excess of his real investment, with little or no economic substance. It is more difficult for taxpayers with large amounts of economic income to completely avoid taxes.

The improvements in making the system more equitable have been achieved largely at the expense of much greater complexity. Income averaging, the preference tax system, complex rules governing charitable contributions and many other items that we can think of have made the system incomprehensible to millions of taxpayers. The phenomenal growth in tax return preparation services over the last quarter century is a clear indication of the fact that most taxpayers simply cannot cope with our complex tax system.

In this regard, a great deal of the complexities that have been created stem from the almost fanatical compulsion of the tax writing committees and staffs to try to achieve perfection and to anticipate every conceivable way that a provision might be avoided.

With respect to economic impact, the system still contains some bias against savings and investment, although it was better after the 1981 Act than 25 years earlier. Adoption of the ACRS system in 1981 and more cautious changes made earlier with the ADR tax depreciation system recognized to some extent the impact of inflation on business investment. By permitting more rapid recovery of cost, the risk of erosion of investment caused by inflation is reduced. The expansion of tax deferred investment vehicles, such as HR-10 plans and IRAs, is providing significant incentives for savings.

In my view, the most important change in our income tax structure over the last 25 years is the reduction in tax rates. This started on a modest scale in 1964, was continued when the maximum tax on earned income system was adopted in 1969, and reached fruition in 1981 with the reduction in the top individual rate and the top estate tax rate to 50%.

I have always felt that the greatest cause of artificial tax planning schemes and abusive tax shelters is high individual tax rates. When an individual has significant amounts of income subject to Federal taxation at a 70% rate or higher, he is less concerned about the economics and substance of an investment since he is investing one of his dollars to two of the government's.

The 1982 Act, TEFRA, is obviously not my choice for the best tax bill of the century. With the possible exception of eliminating some abuses in the mergers and acquisition and retirement plan areas, I give TEFRA low marks by almost any criteria. The dominant motive behind TEFRA was purely and simply dollars. The Congressional budget committees directed the tax committees to raise $100 billion over three years, and that is precisely what they did, if you can believe the revenue estimates that attach to TEFRA's various provisions. I give TEFRA about a "3."

WHERE DO WE GO FROM HERE?

Debate on tax policy in the 98th Congress seems to be starting out on pretty much the same basis as 1982. Understandably, Congressional leaders are concerned about projected budget deficits in the $200 billion range and up, not only for fiscal 1984 but stretching well into the future.

The deficit arises because projected spending (around $850 billion for fiscal 1984) exceeds anticipated revenues (about $650 billion). It does not take a genius to note that it can be reduced by (1) increasing revenues, (2) decreasing expenditures, or (3) a combination of these. To the extent the budget deficit is not reduced, the government must borrow and this puts further pressure on the available capital in this country, where the government is already taking an increasingly large share in competition with the private sector.

While none of us likes to see large government deficits, particularly continuing indefinitely into the future, some believe that, when the economy is still relatively weak even though showing some signs of recovery, it may be better to live with deficits than to impose additional taxes on a fragile economy. Our main concern now should be to encourage the economy to grow, and to encourage people to save, so that more capital will be available at a reasonable price.

Congress is obviously faced with a real dilemma, and it will have to balance conflicting demands in attempting to come up with a solution which is the least bad of several undesirable alternatives. The end result is likely to be another round of tinkering with the tax system, much like that in 1982.

Since different tax changes affect different groups in different ways, we see great tension between different sectors of our economy. Small business vs. large business, labor vs. capital intensive, companies involved in research and high technology, particular problems of service industries—these often create conflicting demands for changes in our tax system. The somewhat uniform business backing for the 1981 Act seems a thing of the past, and we are likely to see greater stress on the tax legislative process further into the 1980s.

CREDIBILITY OF REVENUE ESTIMATES

We have noted that the dominant factor behind the 1982 Act, and probably 1983, is raising revenues. This leads to the question of how revenue estimates from tax changes are determined. This has been a controversial factor in tax legislative deliberations for many years and needs to be reexamined.

Basically, when a tax change is proposed, the staffs of the Treasury Department, Joint Tax Committee and, in some cases, the Congressional Budget Office, develop estimates based on the number of taxpayers affected, the volume of economic activity that might be involved, assumptions as to inflation and the rate of growth in a particular economic sector, and other factors. This results in a dollar figure relating to the particular change. Generally, this approach assumes no change in taxpayer behavior if the tax laws are changed.

Common sense suggests this is seldom a valid assumption. Traditional revenue estimates also generally don't consider secondary or tertiary effects—so-called feedback. A couple of examples illustrate this point.

In 1978, when capital gain reduction was under consideration, Treasury officials estimated that reducing capital gains taxation would reduce tax revenues by approximately $2 billion for 1979, the first full year of the reduction. Advocates of capital gain reduction argued that, if rates were reduced, the volume of transactions generating gains would increase, taxpayers locked into an investment would have greater incentive to liquidate their holdings and, on an overall basis, including additional commissions for securities dealers, tax revenues might increase. This is precisely what happened. Rather than a revenue loss for 1979 of $2 billion, recent analyses show that tax revenues from capital gains transactions *increased* by nearly $2 billion for 1979, and $700 million for 1980.

Another recent example involves an estimate of the tax effect of eliminating the current deductibility of intangible drilling costs (IDC) for oil and gas wells. Joint Tax Committee staff estimates indicate a revenue gain while a Price Waterhouse study of this issue came up with the conclusion, with which I fully agree, that eliminating the intangible drilling cost expensing election would probably cause a revenue loss. Elimination of current expensing of IDC would probably decrease exploration and drilling activities which would cause cutbacks in sales of goods and services for items used in drilling. Earnings and taxes of drilling workers would be cut back, and businesses providing drilling services would have lower profits which, in turn, would reduce their taxes.

Revenue estimating is not an exact science, whether under the traditional static approach or considering feedback and other changes that might occur if tax changes are enacted. Since estimated revenue effects are given such importance by Congressional committees, however, I hope that a better method of estimating can be developed.

PROSPECTS FOR THE 1980s

There is more concern today about the complexity of the tax system than I have ever seen. The frequency of changes as well as their magnitude makes it almost impossible for even highly skilled tax professionals to keep current. This creates almost insurmountable problems for the Internal Revenue Service and Treasury Department who must interpret and administer these changes through regulations and rulings. The backlog of regulations projects is nearly 500, and the Chief Counsel's Office at the IRS is losing ground.

Congress is beginning to show interest in broad conceptual changes in the tax system, rather than continuing to tinker with the income tax rules. There is growing support for the proposition that our present income tax system, as the major source of Federal revenues, has outlived its usefulness. A broadly based income tax system, with a single rate (sometimes called a flat tax) or a smaller number of progressive rates, has generated a great deal of rhetoric and in time may receive serious consideration.

The Bradley-Gephardt approach, now called the "Fair Tax" system, has probably received more attention than other flat tax proposals. The Fair Tax bill would materially broaden the income tax base by eliminating most deductions and credits. However, payments by individuals for home mortgage interest and taxes, charitable contributions, state income taxes, and contributions to IRAs and Keogh plans would continue to be deductible. A 14% tax rate would apply to this broadened tax base. A surtax of 12% would apply to adjusted gross income (AGI) in excess of $25,000 ($40,000 on joint returns), and 16% on AGI over $37,500 ($65,000 on joint returns).

Because of the structure of the tax, itemized deductions such as contributions, mortgage interest, and state income and property taxes would generate tax benefit only at the basic 14% rate.

Corporations would pay a flat rate of 30%, and many existing deductions, credits, and exemptions available to business entities would no longer be allowed.

The Bradley-Gephardt approach is cleverly constructed. By retaining deductions for homeowners' mortgage interest and taxes and charitable contributions, it tries to avoid the political land mines that other flat tax proposals are likely to encounter. Charitable institutions and real estate and construction groups are powerful adversaries against any tax proposals that would jeopardize their interests.

The alternative of moving toward a consumption tax will have to be explored seriously before this decade is over. With anticipated continuing high deficits and the need for a broader and more stable tax base, a consumption tax has a lot of appeal. The two types being discussed most frequently are (1) a transactional tax like a value-added or national sales tax and (2) an annual determination of total consumption, to be taxed under a graduated rate structure. This latter approach was suggested by the Ford Administration Treasury team in its "Blueprints for Basic Tax Reform," issued over six years ago.

The major political factors arguing against Federal consumption taxes generally relate to the redistribution of tax burden among taxpayer groups and shifting toward a more regressive tax system. These problems can be answered to some extent by the way the tax is structured, but there remains a strong perception of regressivity about any consumption tax. This will create significant political problems whenever such an approach is seriously proposed.

We have tinkered with the income tax system long enough and have tried to use it to accomplish objectives that it cannot solve effectively. It is time for a change. With all of the traumatic problems we are likely to have in switching to a new type of tax structure, whether consumption-oriented, fair tax, or flat tax, I firmly believe that is the direction tax policy should take in the next decade.

About the Author

WILLIAM C. PENICK recently retired as Senior Partner–Legislative Tax Policy for Arthur Andersen & Co., in Washington, D.C. Mr. Penick serves on the Board of The Tax Council and is a member of Tax Foundation's Tax Advisory Group. He has been involved in tax policy matters with the American Council for Capital Formation, the American Enterprise Institute, and the American Institute of Certified Public Accountants.

This paper is adapted from remarks presented by Mr. Penick before the Golden Gate University, Tax Luncheon Series, in May 1983. The views expressed are those of the author and do not necessarily reflect those of the Tax Foundation.

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TAX FOUNDATION'S MONTHLY VOL. 27, NO. 7 AUGUST/SEPTEMBER 1983

TAX·FEATURES

Local Government Revenues Triple Over Ten-Year Period

General revenue of local governments topped $257 billion in fiscal 1981 (the latest year reported), nearly three times the 1971 level of $92 billion. From 1980 to 1981 alone, local general revenues rose by $24.7 billion, or 10.6 percent.

Intergovernmental aid to localities totaled $111 billion in 1981, with Federal and state funds combined accounting for a 43 percent share of local revenue for that year and 47 percent of the growth in local revenue for the decade. Direct Federal aid rose from just over $3 billion in 1971 to more than $22 billion in 1981—up 561 percent. State aid increased from $31 billion to $89 billion, or 186 percent.

Property taxes remain the largest segment of locally collected revenue, rising from $37 billion in 1971 to $72 billion in 1981. This 96 percent increase, however, was the smallest rate of growth recorded for any major revenue source. As a result, the relative share of local general revenue derived from property taxes slid from 40 cents per dollar of revenue in 1971 to 28 cents in 1981. (As a share of locally collected taxes, the property tax fell from 85 percent of the total in 1971 to 76 percent in 1981.)

Local sales and gross receipts taxes showed almost a fourfold increase for the decade, but still accounted for only a small share of total local general revenue—about 5 cents per dollar in 1981. The rise was greatest for general sales levies, which rose from $2.3 billion in 1971 to $9.2 billion in 1981.

Other local taxes, including income taxes and licenses, accounted for less than 4 cents per dollar of general revenue in 1981, up only slightly as a share for the decade.

In 1981, local governments raised nearly $51 billion (almost 20 percent of total general revenue) through charges for public services and other nontax receipts.

(Continued on page 2)

We Are Moving!

Effective August 30, 1983, our new address is:

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State and Local Taxes May Top $300 Billion In 1983 Calendar Year

State and local general tax collections will probably exceed $300 billion in the 1983 calendar year, for the first time in history, according to Tax Foundation analysts. This would follow in short order the passing of the $200 billion mark in 1979.

For the years 1977-1982, state-local taxes rose by amounts averaging 8.4 percent annually, even with persistent recessionary conditions in the private economy. The cumulative 5-year increase was 50 percent—56 percent for states and 42 percent for localities.

Growth has been especially rapid for the more "broadly based" taxes. State and local units collected $52.7 billion in individual income taxes in 1982, 71 percent more than five years earlier.

General sales and gross receipts tax collections, at $61.9 billion in 1982, rose by 60 percent for the 1977-1982 period. One-fourth of the total dollar increases in general state-local taxes during these five years was attributable to general sales.

General tax collections of local governments passed the $100 billion mark in 1982, owing primarily to a sudden resurgence in property tax growth. In an unexpectedly high rebound from the "Prop 13"

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Composition and Growth of Local Government Revenue by Source
Fiscal Years 1971 and 1981

Source	Amount (billions) 1971	Amount (billions) 1981	Percent of total 1971	Percent of total 1981	Percent change 1971-1981
Total general revenue, all sources[a]	$92.0	$257.2	100.0	100.0	179.7
Total, own sources	57.5	145.7	62.5	56.7	153.5
Total, taxes	43.4	94.8	47.2	36.9	118.2
Property tax	36.7	72.0	39.9	28.0	96.1
Sales and gross receipts	3.7	13.2	4.0	5.1	261.0
Other taxes and licenses	3.0	9.5	3.3	3.7	213.1
Current charges	9.8	31.5	10.7	12.2	221.4
Miscellaneous revenues	4.2	19.5	4.6	7.6	364.3
Total, intergovernmental aid	34.5	111.4	37.5	43.3	223.3
From states	31.1	89.0	33.8	34.6	186.4
From Federal	3.4	22.4	3.7	8.7	561.4

[a]General revenue is exclusive of utility, liquor store, and insurance trust revenue.
Source: Department of Commerce, Bureau of the Census; and Tax Foundation computations.

Burgeoning Medicare Costs Place Funding In Jeopardy By 1991

"About 29 million people are now covered by Medicare at a total cost of $60.2 billion in calendar year 1983."

Congress may have bailed out the retirement and disability part of the Social Security system for the coming generation. But Medicare will soon need the same treatment, according to Tax Foundation analysis of the 1983 reports of the Boards of Trustees that oversee the Medicare program.

About 29 million people are now covered by Medicare at a total cost of $60.2 billion in calendar year 1983. One program is Hospital Insurance (HI), which pays for inpatient hospital care of those aged 65 or over, and is funded by payroll taxes funneled through the Hospital Insurance Trust Fund. The other program is Supplementary Medical Insurance (SMI), which pays doctors' fees, outpatient hospital service, and other medical expenses for those 65 or older, and is funded chiefly by general revenues (75 percent in 1983), with remaining costs covered through premiums paid by users of the program.

Income to the trust funds will total $64.3 billion in calendar year 1983, according to Tax Foundation economists. This luxury of income in excess of outgo will be short-lived, however. Current actuarial projections reveal that large deficits will begin to occur in the Health Insurance Trust Fund in the latter part of the 1980s and that the fund will be completely exhausted in either 1990 or 1991. Presumably, since doctors' bills, outpatient services, and medicine are funded largely through general revenues, money for the SMI will be raised by Federal (non payroll) taxes or borrowing, supplemented by increases in users' premiums.

Unfortunately, the problems of the early 1990s will not be the bottom of the cliff, but only its edge. On the average, if income is to match outgo in the HI Trust Fund between 1983 and 2005, payroll taxes must be increased by over 40 percent or benefit growth must be restrained by about 30 percent, according to current projections.

Foundation economists see even larger problems looming 75 years down the road. According to the actuarial projections through 2055, the HI program alone will explode to 3½ times its 1983 size in relation to taxable wages. This year HI spending will amount to 2.77 percent of wages and salaries subject to payroll taxes. By 2055, such outlays will grow to 9.37 percent of covered payroll. And this figure assumes that, after 2005, health care costs per unit of service will increase only at the same rate as average wages.

In recent years, this has not been the case. The rise in health costs outpaced wage increases by nearly 16 percent during 1973-74; they are now exceeding annual wage increases by 9 percent and are projected to rise about 2 percent faster than wages in 2005.

(LOCAL REVENUES, from page 1)

"1982 hallmarks the first time in 12 years that property taxes increased as a proportionate share of general state-local tax revenue."

This compares with $14 billion in 1971 (representing an increase of 262 percent), and $44 billion in 1980 (a one-year leap of almost 17 percent).

Interest earnings on local units' cash and security holdings—a significant share of the "miscellaneous revenue" total, amounted to $10.7 billion in 1981, up from $1.8 billion in 1971 and $8.2 billion in 1980.

Although recent increases in local revenues have been sizable, growth in the last half of the decade did not measure up to that experienced during the first. Growth during the 1971-81 span showed a moderate deceleration, from an increase of 77 percent for the period 1971-76 to one of 58 percent for the period 1976-81.

The table on page 1 offers further details.

MARK YOUR CALENDAR

Tax Foundation's 35th National Conference and 46th Annual Dinner will be held this year on Wednesday, November 30, 1983, at the Plaza Hotel in New York City. The title of the Conference is "Taxes, Spending and Growth—Seeking a Balance." Complete details and reservation forms for the Conference and Dinner are in the mail.

(STATE/LOCAL TAXES, from page 1)

slowdown of the late 1970s, property taxes jumped by $10.5 billion between 1981 and 1982, accounting for better than half of the year's net increase of $19.6 billion in general state-local collections.

Also noteworthy, 1982 hallmarks the first time in 12 years that property taxes increased as a proportionate share of general state-local tax revenue—from 30.0 to 31.7 percent.

The table below offers details on state-local taxes for the years 1977-1982.

State and Local Taxes
By Level of Government and by Type[a]
Years 1977 and 1982[b]
(Millions)

Level of government and type	1977	1982
Total	$182,772	$273,930
State	106,111	165,116
Local	76,661	108,814
Individual income	30,852	52,742
Corporation net income	9,709	13,494
Property	64,164	86,811
General sales and gross receipts	38,740	61,910
Motor fuel sales	9,365	10,597
Tobacco product sales	3,684	4,210
Alcoholic beverage sales	2,309	2,909
Motor vehicle and operators' licenses	4,961	6,712
All other	18,988	34,545

[a]General taxes only; excludes unemployment payroll levies that totaled $17,617 million in fiscal year 1981 (latest reported).
[b]Twelve-month periods ending in December of years indicated, based on quarterly reports.
Source: Department of Commerce, Bureau of the Census.

Monthly Tax Features

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Social Security Reform No Panacea

Congressional action on the Social Security system this spring, welcome though it is, falls far short of solving the problem of overall Federal deficits in the foreseeable future, Tax Foundation economists say.

In the past five years, deficits in the Old-Age, Survivors, Disability, and Health Insurance (OASDHI) program have totaled $60.4 billion, accounting for about 11 percent of accumulated Federal deficits for the period. In all other programs combined— budget and off-budget—deficits have totaled $485.2 billion or 89 percent of the combined total of $545.6 billion for the years 1979-1983.

The annual report of the Board of Trustees of the OASDHI Trust Funds, released in June, projects that balances in retirement, survivors, and disability funds

(Continued on page 4)

Federal Deficits and OASDHI Transactions
Fiscal years 1979-1983
(Dollar Amounts in Billions)

Fiscal year	Federal deficit[a]	OASDHI deficit	Deficit excluding OASDHI funds[a] Amount	Percent of total
1979	$– 40.2	$– 6.5	$– 33.7	83.8
1980	– 73.8	– 6.4	– 67.4	91.3
1981	– 78.9	– 8.3	– 70.6	89.4
1982	– 127.9	– 13.1	– 114.8	89.8
1983	– 224.8[b]	– 26.1	– 198.7	88.4
Total, 1979-1983	$– 545.6	$– 60.4	$– 485.2	88.9

[a]Budget and off-budget.
[b]Revised to $– 226.0 billion in Mid-Session Review of the 1984 Budget.
Source: Office of Management and Budget and Tax Foundation computations.

THE FRONT BURNER

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"Why a Balanced Budget Eludes Us"

Q. When is a ceiling not a ceiling?
A. When it's a floor.

That, in a nutshell, is why a balanced Federal budget has eluded those formulating the nation's tax and fiscal policy. When the Congressional Budget and Impoundment Control Act of 1974 was passed, the spending levels built into the first and second concurrent resolutions were intended as ceilings. Congressional appropriation committees were to spend *no more than* the dollar amounts specified.

With their penchant for wooing constituents with goodies, the ceilings quickly became floors. Congressional big spenders (often with the acquiescence or overt encouragement of Executive Branch agencies) made sure they spent no less than specified in the Budget—and then some.

The upshot has been a relentless escalation in Federal outlays for domestic social welfare programs and an equally relentless growth in Federal deficits.

Another reason why budget balance would elude us, even if we had all the tax revenues in hand to pay off the national debt, is that Washington would quickly find justification for new spending. There is an endless number of worthwhile programs. Strong arguments can be made in the name of compassion and human decency to justify virtually any kind of "people" oriented outlays. Until we realize that, just because a program is a worthy idea, it is not automatically obligatory for the taxpayers to foot the bill, a balanced budget will remain beyond our reach.

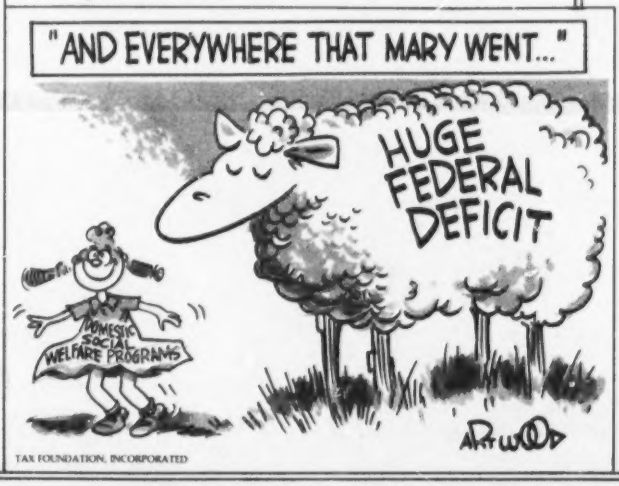
As has been observed before in this column, politicians find it easy to give away money.

With the 1984 elections waiting in the wings, it is highly unlikely that we will see any cuts in domestic spending.

How can spending be restrained? One partial solution might be found in opening up the budget process. Under the present scheme, those from the private sector who are interested in holding down spending have no significant input until the presidential documents are in print. Why not include input from the private sector, informal consultation from analysts outside government, and even formal hearings? This could take place both as the Budget is being developed by the agencies under the supervision of the Office of Management and Budget, and while the Budget Committees of the Congress—and the appropriation committees, as well—are formulating their responses. We prepare regulations this way. Why not budgets and spending proposals?

If the spenders had to conduct their giveaways in the open, a little daylight might go a long way toward holding them in check.

"With the 1984 elections waiting in the wings, it is highly unlikely that we will see any cuts in domestic spending."



Varied Portrait of U.S. Economy Emerges in New "Facts & Figures"

Facts and Figures on Government Finance, Tax Foundation's widely used handbook on public finance, is scheduled for publication this fall. This biennial volume offers a comprehensive view of taxes; government spending; borrowing; government programs and services; Federal, state, and local tax rates; and social insurance, along with many relevant economic indicators. The 283 tables contained in this 22nd edition include 38 brand new tabulations. Among the highlights are:

"Governments in the United States ran a record deficit of $117.4 billion in calendar year 1982."

Governments in the United States ran a record deficit of $117.4 billion in calendar year 1982, topping the previous peak red-ink year of 1975, when they spent $63.8 billion more than they received in revenues.

The Federal deficit amounted to $149.5 billion in calendar year 1982. It was partly offset by a $32.1 billion surplus in state-local operations that resulted from a buildup of balances in social insurance accounts, largely pension funds.

* * *

On general accounts, states and localities ran a $4.1 billion deficit in 1982, up from $75 million the previous year. Deficits as such do not show up in most official state-local budgets, however, because of budgeting methods that provide separate accounting for current and capital spending.

* * *

There were 82,688 government units in the United States in 1982, about 72,000 fewer than forty years earlier. The decline reflected the consolidation of school districts, from 108,579 in 1942 to 15,032 today. Trending in the opposite direction were special districts, a form of local government, which accounted for 28,733 of all units in 1982. Over 20,000 such jurisdictions have been created since 1942, nearly 5,000 of them in the past ten years alone.

"Taxes paid to all governments in the United States in 1982 were more than four times the 1967 amount."

* * *

The Tax Foundation's Tax Index, measuring trends in taxes at all levels based on 1967 as 100, moved up in 1982 for the 24th consecutive year, reaching 413.9. That is to say, taxes paid to all governments in the United States in 1982 were more than four times the 1967 amount. The U.S. output index in 1982, as measured by Gross National Product, stood at 382.6 percent of its 1967 level.

* * *

In 1982, the capacity utilization rate in manufacturing was 69.8 percent—the lowest on record in data going back to 1948. The previous low (72.9 percent) occurred in 1975.

* * *

Taxes of U.S. governments amounted to 30.72 percent of Gross Domestic Product (GDP) in 1980. U.S. taxes claimed a smaller share of output than taxes in the United Kindom (36.14 percent) and in Germany (37.37 percent), but look a larger share than in Japan (26.06 percent). The highest relative tax levels for 1980 were in Sweden (49.63 percent of GDP and $7,382 per capita), followed by Norway (47.31 percent of GDP and $6,645 per capita). U.S. taxes per capita in 1980 were $3,408.

State and local governments held $454.4 billion in cash and securities at the end of fiscal year 1981. Slightly more than half was held for insurance trust systems—largely employee retirement funds.

* * *

In fiscal year 1982, nearly half of all funds raised in U.S. credit markets were raised under Federal government auspices. Most of the $199.7 billion credit garnered by the Federal government was through borrowing from the public. There have been significant variations in the Federal participation rate over the past decade, with swings from 12.9 percent of the total in 1974 to 40.4 percent in 1976, to 18.9 percent in 1979 and 48.9 percent in 1982.

* * *

Wisconsin was the first state in the continental United States to levy both individual and corporate income taxes; it imposed both in 1911. (Hawaii introduced both income taxes in 1901.) Mississippi levied the first state general sales tax in 1932; it was quickly followed by 23 other states during the 1930s. New York State imposed an individual income tax in 1919, but did not levy a general sales tax until 1965.

* * *

In 1981, voters rejected 42 percent of the $8.8 billion in proposed new municipal bond issues, approving issues valued at $5.0 billion. Since 1947, the peak year of taxpayer opposition to new bond offerings occurred in 1975, when voters turned down 71 percent of the value of proposed issues.

Consumption Tax Study Available

"Consumption Tax: An Idea Whose Time is Coming" is a special report from the Tax Foundation which examines the consumption-based income tax, one possible solution to the problems which the present Federal tax system is encountering.

The new study examines the history of the idea, its current chances of success in Washington's political climate, and shows how such a tax would work by means of a sample "consumption tax annual return."

Copies are available from the Tax Foundation for $5, plus $1 postage and handling.

(SOCIAL SECURITY, from page 3)

will rise from $24.8 billion on December 31, 1982, to between $39.7 billion and $45.3 billion by the end of December 1987. (Financing problems in the Hospital Insurance program are discussed elsewhere in this issue.)

According to the Administration's Mid-Session Review of the 1984 budget, issued in late July, Federal deficits under current laws are estimated at $226.0 billion in 1983 and $217.4 billion in 1984, rising to $244.1 billion in fiscal year 1987, for a total of more than $1.1 trillion over the five years.

The table on page 3 shows the impact of OASDHI costs on Federal deficits.